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UNIVERSITY OF ALBERTA

RETURN TO GATT: CHINA'S MOVE TO PARTICIPATE IN THE MULTILATERAL TRADE SYSTEM

BY

WEIYA LIANG

A THESIS
SUBMITTED TO THE FACULTY OF GRADUATE STUDIES
AND RESEARCH IN PARTIAL FULFILLMENT OF THE
REQUIREMENTS FOR THE DEGREE OF MASTER OF ARTS

DEPARTMENT OF POLITICAL SCIENCE

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Weiya Liang

#4 10630 - 83rd Ave
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IN PARTIAL FULFILIMENT OF THE REQUIREMENTS FOR THE DEGREE OF Master of Arts

IN POLITICAL SCIENCE.

Dr. T. Keating, Supervisor

Dr. J.A. Lejnieks

Porfessor L.C. Reif

Date April 16th, 1993

Abstract

The present study is undertaken to examine China's move to participate in the General Agreement on Tariffs and Trade: its implication to the world trade system and its complications due to China's existing economic structure. China's position in the world political spectrum, the volume of its foreign trade and the size of its market make China's effort to resume its GATT seat an epoch-making event. Due to historic reason and China's economic structure, China's assession to the GATT has created certain problems for the Contracting Parties. The biggest concern is China's socialist economy and its foreign trade regime. Arguments are made here to show that the reforms in China in the past decade have substantially changed its old economic structure and, as a result, China should be accepted into the GATT system in the near future. China's continued efforts to move its economy into a market-oriented one should eliminate most of the worries the West has about China's re-entry. China has had experience in dealing with world economic organizations before when it entered the IMF and the World Bank, while the GATT also allowed centrally planned economies to become members of the contracting parties in the past. Several options for China to participate in the GATT are probed and arguments are made for China to enter the GATT as a member with full capacity rather than one with limited privilege.

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TABLE OF CONTENTS

Introduction 1

Chapter One: China and the GATT: History and Background 4

1.1. The General Agreement on Tariffs and Trade 4
1.1.1. Principles of the GATT 6
1.1.2. Procedures to Become a Member 10
1.2. Centrally Planned Economy 13
1.3. East European Countries 15
1.4. China's Participation in GATT 19
1.4.1. The Four Stages of Participation 20
1.4.2. The Ideological Change 22
1.5. Summary and Conclusions 23

Chapter Two: Reforms: Preparations for GATT entrance 25

2.1. Prelude to the Economic Reform 26
2.2. The Rural Reforms 28
2.3. The Special Economic Zones 33
2.4. The Urban Reforms 36
2.5. Summary and Conclusions 41

Chapter Three: China's Experience with the IMF and the World Bank 43

3.1. Initial Contacts 43
3.2. Adjustments 46
3.3. Summary and Conclusions 47

Chapter Four: Negotiations to Join the GATT 49

4.1. The GATT Difference 49
4.2. Concerns of Major Players of GATT 52
4.2.1. The American Concern 53
4.2.2. Sino-Japanese Trade Relations 55
4.2.3. European Community's Position 56
4.3. China's Position 57
4.3.1. Resumption Versus Accession 57
4.3.2. Tariff Concessions 59
4.3.3. China's Developing Country Status 60
4.4. Summary and Conclusions 62

Chapter Five: Solution: A Full GATT Membership? 64

5.1. Limited Membership 65
5.2. Staged Membership 66
5.3. Unlimited Membership 67
5.4. Summary and Conclusions 69

Conclusion 71

References 73

Introduction

In his State Report to the Chinese People's Congress in April 1992, Chinese Premier Li Peng expressed once again that China wished to "resume as soon as possible its legitimate position in the General Agreement on Tariffs and Trade" (GATT) so that it could develop and enjoy a beneficial trade relationship with the rest of the world.[1] Again in October, Chinese Communist Party General Secretary Jiang Zemin urged further reforms to China's foreign trade regime in order to expand foreign trade and make it conform with international trading standards[2] Since China formally applied for the resumption of its GATT seat in 1986, Chinese leaders have pressed hard for China's quick return to the General Agreement. Many foreign observers regard China's move to rejoin the GATT system as an epic transition and a significant move in world trade.[3] China's bid to rejoin GATT will have tremendous implications for international trade and its relations with other states.

The purpose of this thesis is to examine China's historic relationship with GATT, analyze China's economic reform, assess the current situation in China's re-entry attempt, and probe solutions for China's participation in GATT. Arguments are made to show that China, as a result of its unique position due to historic reason and its economic structure, should be accepted into the GATT system in the near future. The paper intends to argue that China's economic reform in the past decade have created favorable conditions for China to rejoin the GATT. Despite the existing problems facing China's accession, the time is riper now than ever before for the world trade organization to accept China with full membership privileges.

As the most populous country in the world, China's membership in the GATT will not only affect the lives of more than one billion Chinese people, roughly one-fifth of the world's population, but also have a big impact on the rest of the world. China's opening to the outside world means that potentially the world's largest market would be more accessible to international business and investment, and most importantly to international trade. Its accession to the General Agreement will also mean that GATT now be more representative due to the nature of China's economy and its trade position in the world.

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[1] Li Peng, *the People's Daily (Overseas Edition)*, April 6, 1992, p2.

[2] Jiang Zemin, *the People's Daily (Overseas Edition)*, October, 13, 1992, p1.

[3] J.E.D. MaDonnell, "China's Move to Rejoining the GATT System: an Epic Transition" in *The World Economy*, 1987, Vol. 10, p331 and Robert E. Herzstein, "China and the GATT: Legal and Policy Issues Raised by China's Participation in the General Agreement on Tariffs and Trade" in *Law and Policy in International Business* , 1986 Vol. 18, p371.

Since the late 70's and early 80's, China has undergone fundamental changes in its economic structure. Economic reforms have transformed the Chinese economy from a stagnant, autarkic economic structure into today's more open and vigorous one. China's GDP grew at a rate of around 10 per cent annually. Its foreign trade activities and volume have increased tremendously during the past decade, making China the 15th largest trader in the world in 1992. Clearly if China wants to obtain more reliable access to international markets, secure its share of world trade and avoid unfair treatment of its exports, it needs to be a full member of the General Agreement on Tariffs and Trade, under whose protection, China will enjoy more preferential treatment in its foreign trade. However, China's success in becoming a full member of the GATT will depend on the compatibility of its economy with the principles of the General Agreement and the continued reforms in its economic structures. To illustrate this, the thesis will explain how China can become a member of the GATT through a study of current reforms in China and assess the reforms to determine if they are likely to meet GATT requirements.

China is interested in becoming a member of the GATT for several reasons. First and foremost, GATT membership will help China move beyond the current bilateral trade relations with many of its trading partners. Such relations time and again have proven to be fragile and unreliable. Under the multilateral principles of the GATT, China will be able to gain equal treatment with other contracting parties and perhaps a relatively more reliable market access. Meanwhile, China's participation in the GATT will also send a strong and clear message to the contracting parties that it is committed to the principles of the organization and will abide by the rules and regulations. It will also assure the contracting parties that China is willing to be a reliable long-term trading partner. Finally, as a full member of the GATT, China will have a chance to participate in the future discussions on GATT to formulate new rules that govern future trading practices, and ensure that its economic influence reflects its economic status.

In addition to these implications, China's bid to rejoin the GATT also has created some problems and complications for the trade organization. After the break-up of the former Soviet Union, China emerged as the last major communist stronghold with a self-claimed socialist ideology. Most importantly, China's economic structure, though having undergone great changes, is still basically a centrally planned one which generally speaking contradicts the ideas and principles of the GATT. China's efforts to become a member of the GATT will undoubtedly present challenges to the world trade body. The first challenge will be China's centrally planned economy and its structure. Dealing with centrally planned economy has never been GATT's original intention, since the basic task for the GATT is to reduce tariffs and remove other trade barriers among contracting parties whose economies are

presumably market driven. Despite drastic changes through economic reforms in the past few years, China's economic structure is still largely planned. Its main foreign trade regime needs further reform and the irrational pricing system demands revamping. Although the GATT has had previous experience with other socialist countries with centrally planned economies, it has never before dealt with an economy as large as China's. Another challenge for the GATT is China's status in the organization. As one of the original signatory governments, China (then represented by the Nationalists in Taiwan) withdrew from the General Agreement in 1950. What China wants now is to resume its seat in the organization instead of acceding as a new member, which might face the evocation of certain regulations of the GATT by some contracting parties. Finally, China's resumption to GATT membership will have to take into consideration the positions of Hong Kong and Taiwan. The former, already a member of GATT, will revert to Chinese rule in 1997; and the latter has applied for its own membership even though it is regarded as a part of China.

The thesis will in Chapter One review China's relationship with the General Agreement on Tariffs and Trade, analyze the incompatibility of a centrally planned economy and state trading practices with the principles of the GATT, and provide a study of the cases of some former East European countries with socialist economies. It will also examine the most common procedures needed to become a GATT member. While Chapter One attempts to provide a background study of the pertinent issues involved in China's drive to become a full member of the GATT, Chapter Two will focus on China's economic reforms to illustrate how China has prepared itself for GATT entry. Aspects of the reforms are presented to show that the economic reforms, which have changed the life of the Chinese people so drastically in the past decade, will eventually transform China's centrally planned economy to a market based one if further changes in China's economic structure continue. Chapter Three looks at China's experience with two key international economic organizations, namely, the International Monetary Fund and the World Bank. The experience China obtained from dealing with these organizations helps in China's preparation to rejoin GATT. The next chapter studies China's trade relationship with members of the contracting parties. An analysis of concerns of some major players of GATT is provided to understand where they stand on China's participation in GATT. Chapter Four will also include a study of China's position and its three principles. Finally in Chapter Five, the paper will explore possible solutions for China to rejoin the General Agreement.

Chapter One

China and the GATT: History and Background

As one of the signatory countries of the General Agreement on Tariffs and Trade, China has had a special historical relationship with the trade organization. It will be in a unique position if it rejoins GATT after having no contacts with the trade organization for 36 years. This Chapter will review the relationship between China and the GATT in the past four decades. It will also include an analysis of the incompatibility of a centrally planned economy and state trading practices with the principles of the GATT. Finally the Chapter will study examples of some former East European socialist countries which may provide an indication of the issues facing China in its pursuit of its GATT seat.

1.1. The General Agreement on Tariffs and Trade

The international trading rules prevailing in today's world were established after the Second World War in the late 1940s by the General Agreement on Tariffs and Trade. The emergence of GATT as the central international trade establishment after the war however was a development that surprised the signatory countries that drafted the General Agreement. At the beginning, statesmen from the U.S. and other countries had a much grander vision for a new international trade order, an International Trade Organization (ITO). The ITO was to govern most aspects of international trade such as economic activity and employment, economic development, reconstruction, restrictive business practices, inter-government commodity agreements and commercial policies.[1] The U.S. and Britain were involved in the first stage to negotiate the formation and function of the ITO, and a draft charter was prepared and finalized by a Preparatory Committee formed by 18 countries in Havana in 1948, which became known as the Havana Charter. But the proposed ITO was stillborn due to several major problems, including the emergence of a new trading bloc in the creation of the Organization for European Economic Co-operation (OEEC) in Paris, which threatened discrimination against other countries; the existing British Commonwealth Preferences which had been a major target of the American policy; and finally and most importantly, the lack of ratification from the United States Congress.[2] A by-product of the failed International Trade Organization, the GATT was to be a trade agreement designed to record the results of a tariff conference to be held under the auspices of the ITO.

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[1] Kenneth W. Dam, *The GATT Law and International Economic Organization*, 1970, pp10-11.

[2] Karin Kock, *International Trade Policy and the GATT 1947-1967*, 1969, pp53-61.

When the U.S. government proposed the meeting of the Preparatory Committee for the establishment of the ITO in December, 1945, it invited 15 countries, including China, to participate in multilateral negotiations for the reduction of tariffs and other trade barriers. All invited countries participated in the negotiations except the Soviet Union which did not reply to the American invitation.[3] In October 1947, the General Agreement was drawn up in Geneva which incorporated many of the commercial policy provisions of the ITO draft charter. Later the GATT assumed the commercial policy role that had been assigned to the ITO after the Truman administration finally decided not to seek Congressional approval of the ITO Havana Charter.[4] Twenty-three contracting parties signed the General Agreement on Tariffs and Trade, which took effect in January, 1948. Now 45 years later, the General Agreement on Tariffs and Trade has grown to become the world's most important trade regime with over 100 members.

GATT, together with its two financial counterparts--the World Bank and the International Monetary Fund--, has had a great influence on world economic growth and development over the four decades of its existence. The three international economic organizations together established an international economic order that governed the world for most of the post-war era. However, due to the changes and rapid growth in world trade, the success of GATT in stimulating world trade and world economic growth through successive rounds of tariff reductions is in jeopardy. With tariffs of the industrial countries already quite low and the tariff advantages enjoyed by the newly industrialized countries (the NICs) and the less-developed countries (the LDCs), GATT's function in stimulating world trade through additional tariff reductions is severely limited. Many in Europe and the North America regard the GATT as being dated and badly in need of revision.[5] More and more countries which could not solve their trade problems effectively within the GATT framework tend to seek solutions to trade problems outside of GATT in the form of bilateral agreements, regional agreements, or the unilateral use of non-tariff measures. Countries seek to form trading blocks in the world such as the Canada-U.S. Free Trade Agreement, the European Free Trade Zone and the North America Free Trade Agreement tabled by Canada, the United States and Mexico to promote regional trade. Some have suggested that this kind of bilateralism and regionalism would eventually mature into multilateralism.[6] Yet if GATT is to survive as an effective administrator of the international trade rules multilaterally agreed, it needs to update its rules in order to better reflect the

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[3] Ibid., p62.

[4] Dam, *The GATT Law and International Economic Organization*, 1970, pp11-14.

[5] Penelope Hartland-Thunberg, *China, Hong Kong, Taiwan and the World Trading System*, 1990, p5.

[6] Robert Baldwin, *Trade Policy in a Changing World Economy*, 1988, pp253-254.

changes in world trade and cope with them. Suggested changes in the GATT rules have been discussed in four general areas:

1. The unconditional MFN principle, the cornerstone of the GATT, is being honored more in the breach than in the observance and should either be changed or be reasserted.
2. Existing GATT rules, especially those covering 'fair' trading practices, agriculture and textiles, are not stringent enough.
3. There is need for the GATT rules and agreements to be extended to cover such matters as services trade, trade-related investment requirements and the protection of intellectual property rights.
4. Existing GATT mechanisms for settling disputes, reaching decisions and dealing with the developing countries are ineffective and unfair and should be revised.[7]

In addition to these suggestions, the GATT also faces problems in other areas such as the increased use of non-tariff trade barriers, the covert use of quantitative restrictions and other unfair trading practices, e.g. the European farm subsidies. As an organization, the GATT historically has first and foremost attempted to negotiate a reduction in tariff barriers through a series of rounds of tariff negotiations. There have been eight rounds of tariff talks in the history of the GATT. Some of the tariff negotiations such as the Kennedy Round and the Tokyo Round were successful in substantially reducing tariff barriers and made some limited efforts in promoting the trade and development of less-developed countries. During the current Uruguay Round, the Contracting Parties are trying to solve trade problems such as agricultural subsidies, natural-resource-based products, textile and clothing, problems in service sectors and intellectual property,[8] and to map out new rules to modernize the GATT regime. Despite the problems of GATT, the world trade organization has succeeded in promoting freer trade in the world over the decades, and the number of its members has quadrupled.

1.1.1. Principles of the GATT

In order to be a member of the Contracting Parties, some basic principles of GATT must be observed. First of all is the understanding of the nature and objective of the General Agreement. As an international trade organization, "GATT is a multilateral treaty embodying reciprocal rights and obligations designed to achieve certain objectives." The provisions of the GATT are based on the following main principles:

(i) Member countries should grant one another treatment at least as favorable as they grant any other country (the 'most-favored-nation' principle), ...;

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[7] Ibid., pp233-4.

[8] GATT, *Uruguay Round of Multilateral Trade Negotiations*, 1987, pp1-4.

(ii) Protection should be afforded to domestic industries exclusively through the customs tariff and not through other commercial measures (such as quantitative restrictions), and the general level of tariff protection should be progressively reduced through successive tariff negotiations;
(iii) Contracting parties should use the procedure of consultation, directly with other contracting parties or with the Contracting Parties collectively, in case of dispute and to avoid damage to one another's trading interests;
(iv) Contracting parties should take such joint action...as is necessary to further the objectives of the Agreement.[9]

In other words, the main principles of the GATT includes non-discrimination, tariff concessions, reciprocity, consultations and information. The nondiscrimination principle is an obligation for the signatories to apply immediately and unconditionally most-favored-nation treatment in the commerce among themselves. The General Agreement was, in its origin, an agreement on tariffs, and tariff concessions has been one of the primary objectives of the GATT organization. Since its Geneva Round in 1947, the GATT has had seven rounds of talks on tariffs concessions. The most recent ones are the Kennedy, Tokyo and the Uruguay Rounds, all aiming at the reduction of tariffs and other trade barriers. Generally speaking, the GATT has played a significant role in reducing tariffs and promoting world trade. The volume of the world trade rose an average by 7 per cent annually from 1948 to 1973, an increase of more than six times.[10] From 1979 to 1987, trade in goods increased 150 per cent and trade in services, which consists of roughly 30 per cent of world trade, expanded 240 per cent during the same period.[11] Reciprocity in the General Agreement is an exchange of concessions during commercial negotiations where every member aims to maximize its gains from trade co-operation. Finally consultation provides the primary formal technique for the GATT to co-ordinate policies, and information allows members of the GATT to exchange trade facts. These basic principles represent the main features of the GATT and merit some further discussion.

First of all, the non-discrimination principle, which is normally referred to as the most-favored-nation clause, is in many ways the cornerstone of the General Agreement. This clause in Article I of the GATT applies to all tariffs, whether or not covered by a concession. There are three major exceptions in the application of this principle. The first exception is that certain specified preferential arrangements such as the British Commonwealth system of imperial preference were left undisturbed. The

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[9] GATT, *The Role of GATT in Relation to Trade and Development*, 1964, p6.
[10] Finlayson, J.A., "Trade and Global Interdependence" in David G. Haglund & Michael K. Hawes (ed.) *World Politics*, 1990. p284.
[11] Ibid, p289.

second is that custom unions and free-trade areas are exempted from the principle because such arrangements were once regarded as movements towards the GATT goal for freer trade. The third is the balance-of-payment exception, later introduced in Part VI of the GATT, which allows countries, especially developing countries with balance of payment problems, to impose certain kinds of quantitative restrictions.

Second, the GATT expects its members to control trade through prices rather than direct instruments of trade control such as those practised in the state trading countries. The multilateral trade order assumes that there is a direct link between foreign and domestic prices. Tariffs, as price controls in trade, are key elements in the determination of prices. Due to the importance of tariffs, the GATT originated from an agreement on tariffs. It has since provided a framework for tariff conferences for its member governments. Tariff concessions made during those conferences apply to all members alike and the Contracting Parties abide by these concessions. However, certain provisions in the General Agreement allow flexibility for contracting parties. Under special circumstances, contracting parties may modify or withdraw from certain concessions if new and compensating concessions are made.[12] Moreover, the GATT has separate provisions in Article XVIII to allow modification or withdrawal of concessions for less-developed countries when they consider such action necessary to protect developing industries.

Although the GATT deals mainly with tariff reductions and trade negotiations, the contracting parties have recognize that non-tariff barriers to trade also need to be addressed. One of the most important non-tariff barriers, for example, are quantitative restrictions or quotas which are not permitted under the GATT. The GATT has, however, three major exceptions in dealing with quantitative restrictions: for balance of payment purposes (Articles XII-XV); for certain agricultural programs (Article XI), and for the economic development of certain less developed countries (Article XVIII). Non-tariff barriers became a major issue during the Tokyo Round and continue to be important in the Uruguay round. Nevertheless, since the GATT was not designed to cope with non-tariff barriers, it lacks provisions for negotiations on reducing non-tariff barriers and has had a difficult time addressing these satisfactorily.

Tariff concessions are reached through the process of reciprocity among contracting parties through negotiations. "Reciprocity as a concept is nowhere defined in the General Agreement, but it is nonetheless one of the most vital concepts in GATT practice."[13] There are two kinds of reciprocity practised in theGATT. On the one hand, the negotiations between developed countries have been based on the principle of full reciprocity according to concessions

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[12] See Article XXVIII of the GATT.

[13] Dam, *The GATT Law and International Economic Organization*, 1970, p59.

granted and received. On the other hand, the full reciprocity principle does not apply to some less developed countries when they have to maintain the balance of payments and protect their infant industries and when they feel they have nothing to offer as reciprocity. At the ministerial meeting in May 1963, it was agreed that "while every effort should be made to reduce barriers to the exports of less-developed countries, the developed countries cannot expect to receive reciprocity from less-developed-countries."[14] The Contracting Parties in the Kennedy Round added a new Part IV to the General Agreement to deal with the problems of development and the trade of the less-developed-countries.

One of the most important and effective procedures in the GATT to avoid damage to the trade of any one of the contracting parties is the use of consultation to settle differences among contracting parties. Therefore consultation is another basic principle of the GATT. There are two articles, Article XXII and Article XXIII, in the General Agreement that contain provisions relating to consultation. Article XXII states that:

> Each contracting party shall accord sympathetic consideration to, and shall afford adequate opportunity for consultation regarding, such representations as may be made by another contracting party with respect to any matter affecting the operation of this Agreement
>
> The Contracting Parties may, at the request of a contracting party, consult with any contracting party or parties in respect of any matter for which it has not been possible to find a satisfactory solution through consultation... .[15]

Article XXIII deals with nullification or impairment. When a country considers that the benefits which should accrue to it under the Agreement are being nullified or impaired, or the objective of the Agreement is being impaired by the action of another contracting party, it can submit a complaint under the provisions of this article. The Contracting Parties are authorized to make recommendations to change the situation. The Contracting Parties can also authorize the suspension of concessions or obligations against the governments concerned.

Besides consultation, the GATT also imposes certain requirements on member governments concerning dissemination of information because secrecy and lack of information will make trade co-operation and tariff concessions impossible. The signatory countries of GATT are asked to make publications and administration of trade regulations available to each other. Special reporting requirements exist under the GATT regarding state trading, countervailing duties, subsidies, licensing and other such actions. The Agreement also requires that "laws, regulations, judicial decisions and

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[14] GATT, *The Role of GATT in Relation to Trade and Development*, 1964, p7.
[15] GATT, *The Text of the General Agreement on Tariffs and Trade*, 1986, p39.

administrative rulings of general application, ... or the valuation of products for customs purposes, or to rates of duty, taxes or other charges, or to requirements, restrictions or prohibitions on imports or exports ... to be published promptly."[16]

In summary, the principles of the GATT consist of non-discrimination, tariff concessions, reciprocity and consultation and information. A member of the GATT is expected to observe and abide by these principles. These principles also should be agreed upon if any government wishes to join the General Agreement.

1.1.2. Procedures to Become a Member

Normally it is a relatively straightforward procedure for a government which wishes to be a member of the GATT to join the organization. Article XXXIII of the General Agreement outlines the criteria for GATT accession:

> A government not party to this Agreement, or a government acting on behalf of a separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement, may accede to this Agreement, on its own behalf or on behalf of that territory, on terms to be agreed between such government and the Contracting Parties. Decisions of the Contracting Parties under this paragraph shall be taken by a two-thirds majority.[17]

This is called **accession by negotiation**. A government wishing to become a member of the GATT submits to the Contracting Parties a memorandum on its foreign trade regime which is examined by a working party (open to all interested countries) established for the purpose. The working party draws up the terms of the draft protocol of accession. At the same time, tariff negotiations are conducted with the members of the GATT, in the course of which the acceding party grants concessions to GATT members as a counterpart to the benefits it will derive from accession.[18]

In other words, a simple two-thirds majority of the Contracting Parties should suffice to decide the accession of any government as a member of the GATT. However, accession to the General Agreement differs from memberships in other international organizations such as the United Nations, because membership in the GATT means immediate trade benefits already agreed upon by the Contracting Parties. The newly-acceded government automatically becomes the beneficiary of a large number of tariff concessions through the operation of Article II:1. As a practical matter, accession under Article XXXIII requires negotiations between the acceding

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[16] GATT, Article X ,1970.

[17] GATT, *The Text of the General Agreement on Tariffs and Trade*, 1986, p51.

[18] GATT, *Focus*. No. 47, June, 1987, p1.

government and the contracting parties to ensure that certain concessions from the acceding party are offered in return for the privilege of receiving rights in all prior concessions made by contracting parties among themselves. These kinds of concessions on the part of the acceding government in its negotiations for the GATT membership are called an "entrance fee".[19]

New governments may, however, occasionally be able to avoid such an entrance fee, if they are customs territories of a contracting party and wish to become members in the GATT. According to Article XXVI:5(c): "if any of the customs territories, in respect of which a contracting party has accepted the General Agreement, possesses or acquires full autonomy in the conduct of its external commercial relations and of other matters provided for in the Agreement, such territory shall be deemed to be a contracting party upon sponsorship **through declaration** by the responsible contracting party."[20] That is, newly independent countries in respect of which the General Agreement has been previously applied may be deemed to be Contracting Parties through a declaration by the relevant existing contracting party. Since many colonial countries accepted the General Agreement with respect to their colonies, the latter were able to become contracting parties without conducting their own negotiations with the Contracting Parties. Hong Kong is such an example which, as a customs territory of Great Britain, was sponsored by the British government in its accession to the GATT. Hong Kong's status in the GATT is unlikely to change when it reverts to China in 1997, since it was under the British sponsorship and the Chinese acquiescence that Hong Kong became a full member of the GATT in 1986.[21]

Another kind of arrangement for newly independent countries which may prefer not to take a decision on their future foreign trade regime and membership of the GATT is the practice of applying the General Agreement on a **de facto** basis to those countries.[22] De facto applications apply to newly independent states which were customs territories of contracting parties and to which the GATT had been applied. It allows new states to continue to carry out GATT commitments and receive benefits without interruption pending final decisions as to their future commercial policy. De facto applicants still need to negotiate with the GATT on their formal accessions to the General Agreement. For example, Algeria, Congo, Rwanda and Mali are a few countries that acceded to the GATT under such de facto application arrangement.

As a kind of pragmatic adjustment, the GATT has also established two types of arrangements designed to deal with delays required to conclude

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[19] Dam, *The GATT Law and International Economic Organization*, 1970, p109.

[20] GATT, Article XXVI:5 (c) 1986, pp45-6.

[21] Penelope Hartland-Thunberg, *China, Hong Kong, Taiwan and the World Trading System*. 1990. pp101-2.

[22] GATT, *Focus*, No. 47. June 1987, p1.

entrance-fee negotiations. One is the institution of provisional accession which allows some countries wishing to accede to the General Agreement the possibility of **acceding on a provisional basis** for a limited period of time.[23] Under such an arrangement, "the General Agreement is made applicable to the commercial relations between the provisionally acceding state and those contracting parties accepting the particular declaration of provisional accession."[24] Once the tariff negotiations are completed, the provisional acceding party becomes a full contracting party through a protocol of accession under Article XXXIII. Countries such as Argentina, Switzerland, Tunisia and United Arab Republic went through this provisional process. In addition, the former Yugoslavia acceded provisionally to the GATT in 1962 and changed its status from a provisional GATT member to a full member in 1966 after the completion of tariff talks with the contracting parties and its economic structural change.

The other process used by the GATT to accommodate countries which wish to accede but cannot meet the basic requirements of the GATT is to permit countries to participate in the work of the Contracting Parties under **special arrangements**. Such arrangements differ in terms based on the situation of particular case, but it shows that the GATT has the flexibility to accommodate different countries. With Poland for example, the GATT made special arrangements on Poland's commitment to increase the total value of its imports from the territories of contracting parties by not less than 7 per cent per annum.[25] According to this special arrangement, Poland was formally admitted to participate in the Kennedy Round tariff talks in March, 1965, two years prior to its becoming a full GATT member in October, 1967.

The decision to grant an acceding contracting party membership is made by a two-thirds majority vote. The General Agreement also gives each existing contracting party a privilege of refusing to apply the General Agreement to the new member. Since Article XXXV allows non-application of the Agreement between particular contracting parties, any existing contracting party which does not agree to the accession of a new member for any reason may invoke this privilege and refuse to provide trade or tariff benefits to the new member. On the other hand, the new contracting party will also be alleviated from any obligations towards that party. In other words, the General Agreement will not apply between those two governments. Such an arrangement tends to encourage accession while preserving the position of existing contracting parties *vis-a-vis* the new one. The most extensive invocation of Article XXXV in GATT history was utilized against Japan in 1955 by fourteen countries which represented about 40 per cent of the foreign

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[23] Ibid., p1.

[24] Dam, *The GATT Law and International Economic Organization*, 1970, p347.

[25] GATT, *Basic Instruments, 15th supplement*, 1968, p52

trade of GATT. In fact, a total of forty-three different contracting parties invoked Article XXXV against Japan, either directly or by succession.[26]

All these procedures designed by GATT to accept new member states are aiming at governments with a market oriented economy with little or no state trading. There are no specific provisions for states with centrally planned economies. As a basically centrally planned economy with most of its major industries controlled by the State Planning Commission, China's participation in the GATT will first and foremost depend on the adjustment of this structure. China will need to create conditions in which a market oriented economy can develop and prosper. However, China's economy is still based on central planning and the practice of state trading still exists. Unless this is changed, it will inevitably jeopardize China's participation in the GATT.

1.2. Centrally Planned Economy

A centrally planned economic system poses one of the major problems in China's bid to rejoin the GATT because it undermines GATT's two major principles: nondiscrimination (the most-favored-nation treatment) and the custom tariff as the only measure to determine trading. Although the GATT allows state trading in its provisions, it is not armed with provisions regarding the state trading practices of centrally planned economies. In creating the GATT, the Contracting Parties were not well prepared to deal with this kind of economy. There is no explicit definition of "state enterprise" in the General Agreement itself, but it is assumed that the GATT was created for private enterprise economies. A state trading enterprise was thought to be an occasional form of state trading practised in the market economy. The panel of experts summoned by the GATT to examine this issue reached the conclusion that the term "state trading enterprise" means "an instrumentality of government which has power to buy or sell or to a non-governmental body with such power and to which the government has granted exclusive or special privileges."[27] As a result, there is only one section in the General Agreement that deals with the problem of state trading - the provision of Article XVII. This general rule applies to two totally different problems: the first being state trading enterprises within a market economy, and the second being state trading enterprises in a non-market economy. In institutional terms, the former deals with countries with a market economy, yet needs a special arrangement with the GATT to grant state-owned or state-controlled enterprises exclusive rights over certain products. The latter concerns countries without a market economy such as China and the formerly socialist East European countries. These represent two fundamentally different economic systems. Nevertheless, the ambiguous

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[26] Dam, *The GATT Law and International Economic Organization*, 1970, p348.

[27] See Dam, *The GATT Law and International Economic Organization*, 1970, p316.

provision on state trading enterprises is the result of historical factors. When the GATT was established, no country with a centrally planned economy participated in the first round of tariff talks, (the Soviet Union was invited to participate in the negotiations, but did not reply). As a result, there was no reason to include such a provision in the GATT.[28] The provision of Article XVII was meant in the beginning for those states with a market economy whose imports and exports were determined by commercial interests only, as Paragraph (b) of the Article XVII states:

> The provisions of sub-paragraph (a) of this paragraph shall be understood to require that such enterprises shall, having due regard to other provisions of this Agreement, make any such purchases or sales solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of the other contracting parties adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales.[29]

The key word here is "solely...commercial considerations", which can only apply to an economy that is determined by market forces rather than central planning. This is the underlying assumption of the GATT tariff system which pre-supposes that foreign trade is handled by private enterprises whose prime concern is commercial profitability. Trade decisions should be based on whether such purchases or sales would be profitable when the tariff factor is considered. Only tariffs, based on a most-favored-nation principle, should determine the choice of importing or not.

The assumption of the GATT system that tariffs are to influence foreign trade is severely undermined when state trading occurs, especially the state trading practice done by centrally planned economies. It is clear that the decisions of importing and exporting made in a centrally planned economy are not the same as in a market economy. In an ideal centrally planned economy, the price of the product is pre-determined and often at great discount due to state subsidy and other factors rather than just supply and demand. Naturally the price of the product does not reflect the tariff factor. Whereas in a market economy, consumption determines the price of a product and quantities of production. To import or not to import in such an economy is often determined by the tariff imposed on those products. Thus, tariffs are likely to have a more limited influence on the level of imports in a centrally planned economy than in a market economy, because state planners determine the level of imports. Therefore, a centrally planned economy undermines the GATT's main principles, i.e. non-discrimination - the

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[28] GATT, *Basic Instruments, 9th supplement*, 1961, pp183-4.

[29] GATT, The *Text of the General Agreement on Tariffs and Trade*, 1986, p27.

general most-favored-nation treatment and tariffs as a lever in foreign trade. Nevertheless, since there is no provision in the General Agreement that prevents countries with a centrally planned economy from joining the GATT, countries with a non-market economy have become members of the GATT and participated in its activities. As a result, the GATT does have some experience with centrally planned economies. Past decisions to admit centrally planned economies to the organization, however, were carefully considered with extensive consultation among the contracting parties. Certain conditions were also met or some special arrangements were made before these countries could become members of the General Agreement. These cases, most of them involving East European countries, can serve as examples of how a non-market economy could adapt to the principles of the GATT and accede to the Contracting Parties, and how the GATT has included centrally planned economies in the past.

1.3. East European Countries

Five former socialist East European countries and Cuba with a non-market economy are GATT members. The East European members are Czechoslovakia, Yugoslavia, Hungary, Poland and Romania. Among these states Cuba and Czechoslovakia did not have a lengthy application process as they were original members of the Contracting Parties. The other four are formerly socialist East European countries that had a non-market economy when they applied for GATT membership. Their accessions to the General Agreement took different routes due to their individual domestic economic structures and their readiness for participating in the multilateral trading order. Their accessions also demonstrate that once certain conditions were met, countries without a market economy would still be able to join the GATT and that the GATT system had the flexibility to accommodate countries with non-market economy as members of the General Agreement. The chronological relations between those former East European countries and the GATT can be summarized in Table 1.1:

Table 1.1 Chronology of Relations

between East European Countries and the GATT

	1948	Czechoslovakia: founding member of the GATT
	1950	Yugoslavia: oberver in the GATT
October	1957	Poland and Romania: obervers in the GATT
	1959	Yugoslavia: associated member*
November	1959	Poland: associated member*
March	1962	Provisional accession of Yugoslavia to the GATT
	1965	Poland formally participated in the Kennedy Round
November	1966	Yugoslavia: full member in the GATT
June	1966	Hungary: oberver in the GATT
October	1967	Bulgaria: observer in the GATT
November	1967	Poland: full member in the GATT
September	1971	Romania: full member in the GATT
	1973	Hungary: full member in the GATT
	1988	Bulgaria applies for full membership

Source: Information quoted here is gathered from both Kostecki's *East-West Trade and the GATT System*, 1979; and Laszlo Lang's *International Regimes and the Political Economy of East-West Relations* , 1989.

* By association is meant acceptance to declare relations open between the country in question and the Contracting Parties.[30]

It is interesting to note that the chronological relations between the GATT and those East European countries show both political and economic considerations. Politically there is a pattern in the timing of the accessions of those countries to the GATT. There was no action in the first half of the 1950s when the Cold War was prevailing. Continued political-ideological hostility between the socialist camp and the capitalist camp prevented any activities between East European countries and international economic and monetary organizations. It was basically foreign policy considerations instead of economic reform that initiated the process for Yugoslavia to seek accession to the GATT during this period when Tito broke away from Stalin. Positive developments with the socialist countries were picked up ten years later when the height of the Cold War was over and a more politically stabilized world environment was created.[31]

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[30] Original footnote from M. M. Kostecki's table from East-*West Trade and the GATT System*, 1979, p11.

[31] Lang, *International Regimes and the Political Economy of East-West Relations.*, 1989, p34.

Economically speaking, all the East European countries except for Yugoslavia acceded to the GATT due to their trade statistics. In other words, those countries gained accession to the GATT when their trade volume, especially imports from the West, reached such a point that the Contracting Parties of the GATT thought it was large enough for them to enter the General Agreement. For example, Poland, which was the first to join the GATT among the three discussed here, had the highest share of Western imports to total imports. One-third of Poland's total trade was conducted with developed countries. Romania's foreign trade also had an important increase in Western imports and exports since the mid of 1960s. Romania's imports from developed countries jumped from 11.3 per cent in 1965 to 29.2 per cent in 1966, and reached 56.4 per cent in 1967.[32] It became the second CMEA country to access the GATT. This was followed by Hungary which ranks third in the CMEA in regard to its share of trade with the West as a percentage of total trade; 31.6 per cent in 1970.[33] Thus, the timing of accessions of those East European countries to the General Agreement can be attributed to both political and economic considerations. The Yugoslav case confirms rather than refutes the point that political considerations instead of economic criteria led Western governments to invite the Yugoslav socialist regime to the multilateral trade system. Yugoslavia, however, had to decentralize its economy and meet the basic GATT requirements for accession after the initial invitation. As for the other three, it was mainly the economic reforms such as decentralization of the trade regime in the case of Hungary and the promised increase in the level of imports of Western products in Poland and Romania that allowed the accessions of those countries to the GATT.

There are at least four models of countries with non-market economies who have tested the GATT. The first model is demonstrated by Czechoslovakia and Cuba. As original members, they were not asked for an overt commitment to reciprocity. In turn, they did not press to enforce the legal obligations in terms of tariff concessions of the contracting parties. In other words, both the Contracting Parties and those two countries did not really demand from each other full obligations in strict terms.

Another model is revealed in the case of Yugoslavia. It shows that its protracted process for accession can sufficiently decentralize a socialist economy to make it possible to join the GATT under similar conditions as Western market economies, i.e. based on tariff concessions alone. Although a centrally planned economy, Yugoslavia claimed that it had tariff protection, internal competition and the absence of state-trading.[34] Yugoslav accession to the GATT was under special political circumstances because the West viewed

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[32] GATT, *International Trade*, 1967, p231.

[33] Ibid.,1971, p202.

[34] Kostecki, *East-West Trade and the GATT System*, 1979, p32.

it as a particular case among socialist countries since Yugoslavia had long been at odds with the rest of the Soviet bloc both in ideology and practice. The case of Yugoslavia also illustrates that favorable political circumstances can help but not determine accession.

The third model is portrayed by Poland and Romania, whose entrance to GATT was based on promises to increase their imports from contracting parties without decentralizing their economy. In Poland's case, a commitment to increase its imports from the contracting parties by a fixed 7 per cent annually in exchange for the most-favored-nation treatment had satisfied the Contracting Parties into admitting Poland. Romania followed Poland's example in its negotiations with GATT. But instead of setting up a fixed percentage like the Poles, Romania, claiming to be a developing country, entered GATT under a reciprocity arrangement which stipulated that Romanian imports from the GATT countries should increase at a rate no smaller than the total of Romanian imports.[35] Although conditions set for Poland and Romania differ from one another, their admissions to the General Agreement exemplify the fact that it is possible for centrally planned economies to join the GATT under special arrangements.

The accession of Hungary to GATT reveals the fourth model, which very much resembles that of Yugoslavia. Hungary's economy underwent a long adjustment period from 1960 to 1973 and was treated basically as a market economy when it finally acceded to the Contracting Parties. The economic reforms, formally introduced in 1968, included a multi-tier tariff schedule that eventually was accepted by the GATT members as the valid tariff approach. Thus the Hungarian government only undertook the commitment of tariff reduction in its schedule. There was no obligation to increase imports from the GATT members at a fixed percentage as Poland, nor a promise to import from the contracting parties at a rate eventually no smaller to the growth of the total imports like Romania.

These four models offer a pattern that accommodates state trading countries with centrally planned economies in the framework of the General Agreement. The pattern consists of two parts. On the one hand, the GATT will try to allow enough time for those countries to carry out economic reforms that will eventually change their economic structure and basically become a market economy like other members of the organization. This is exemplified by Yugoslavia and Hungary which transformed their economic structure in such a way that the GATT admitted them based on standards similar to those that it accepts for other members. On the other hand, the GATT will grant limited membership to those state trading countries on the bases of their commitments to increase imports from members of the GATT at a rate which satisfies the Contracting Parties.

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[35] Ibid., pp91-133.

Participation of Yugoslavia, Poland, Romania and Hungary in the GATT offers an excellent lesson of experience for socialist state trading countries to conduct trade under the multilateral regime. The arrangements made for Hungary, Poland and Romania in the GATT relied on largely periodic consultations with the contracting parties. Due to the nature of their economies, some contracting parties imposed discriminatory quantitative restrictions on their exports. For Poland and Romania the GATT provided a reciprocity formula based on the exchange of their import commitments with tariff concessions from other GATT members. However, the GATT was not very successful in providing a formula that links Polish and Romanian exports with imports. It also failed to consider an inflation factor, anticipate the shifts in the commodity composition of trade and the adjustment problems that faced those countries when setting up quotas for Poland and Romania. Membership in the GATT did however help both countries to increase their foreign trade with GATT countries as shown in Table 1.2:[36]

Table 1.2

	Poland		Romania	
Year	Imports	Exports	Imports	Exports
1968	6	7.7		
1969	9.3	9.7		
1970	7.9	13.2		
1971	18	12.5		
1972	48.9	24.5	27.2	20.8
1973	65.3	38.7	26.2	60.9
1974	41.8	40.1	61.2	30

While similar to China's economic structure, those former socialist countries differ substantially from China. They were CMEA members (except for Yugoslavia) and their trade with other non-CMEA countries was almost negligible. Nevertheless their application process and accession to the GATT provide good examples for China to study, analyze and follow. China now is undergoing profound changes in its economic structure and economic reforms have introduced many ingredients of a market economy. China can probably follow the examples of Yugoslavia and Hungary in its rapprochement with the GATT and try to further decentralize its economy.

1.4. China's Participation in GATT

China's drive to rejoin the GATT began in November 1982 when China, represented by the People's Republic of China, sent its first observer to

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[36] Source: ibid., p115-9.

the annual meeting of the Contracting Parties.[37] But its connection with the GATT dates back to the founding of the GATT organization. China was involved actively in the discussions in 1946-47 which produced the General Agreement. Represented by its then ruling Nationalist government under Chiang Kai-shek, China participated vigorously in those debates to support the interests of the less developed countries.[38] In March 1948, China signed the final document on the United Nations World Trade and Employment Conference in Havana, and was elected a member of the executive committee of the international trade organization. In April of the same year, it signed the GATT Provisional Suitable Protocol document and formally became a contracting party to the GATT in May.[39]

When the Nationalists were defeated in the mainland and retreated to the island of Taiwan in 1949, they took with them the China seat from all international organizations including that in the GATT. A year later, they withdrew from the GATT due to the fact that Taiwan could no longer represent China in an international trade organization. Since then China has not been a GATT member, although it has participated as an observer in the GATT meetings by the Nationalists between 1965 to 1971 and by the People's Republic since 1982. In January 1984 China formally joined the Arrangement Regarding International Trade in Textiles signed under the auspices of the GATT. In the same year, China applied for and was granted the status to attend as an observer at GATT council meetings and the meetings of its associated organizations and to take part in related activities.[40] In July, 1986, the People's Republic of China formally expressed its desire to resume its GATT membership and has since lobbied for its early return to the GATT China seat, once held by the Nationalists.

1.4.1. The Four Stages of Participation

The development of China's relations with the GATT can be generally classified in four stages. This classification offers a bird's eye view of the relationship between China and the GATT in the past 40 years. The first stage is the early relationship with the GATT from 1945 to 1950, when China was an active participant in the founding process which hammered out the international trade organization, but later reduced its activities due to the civil war and finally withdrew from the General Agreement in 1950. In 1945 the United States and 14 other countries including China, then represented by the Kuomintong (KMT) government, engaged in negotiations to bring about a reduction of tariffs and other barriers to trade. This is the beginning of the process which eventually produced the General Agreement on Tariffs and

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[37] *Beijing Review* No. 10, March 10, 1986 p4.

[38] Hartland-Thunberg, *China, Hong Kong, Taiwan and the World Trading System.* 1990, p6.

[39] *Beijing Review* No. 10, 1986 p5.

[40] J.E.D. MacDonnell, "China's Move to Rejoin the GATT System: an Epic Transition" in *The World Economy,* Vol. 10, 1987, p331-32.

Trade.[41] This first stage of development, especially before 1948, can be characterized as a period of active participation. During the later stage of this period, China was under the rule of the Nationalists and engaged in the final phase of the civil war, which the Nationalists eventually lost, retreating to Taiwan. Due to the crucial stage of the civil war, the Nationalists, which then occupied China's GATT seat, had little time for and activities in international trade except for the import of armaments from the U.S. and its allies.

The second stage began with the withdrawal of Taiwan from the GATT in the mid 1950s and lasted until 1970. During this stage, the People's Republic of China, as a newcomer to the world political stage, maintained no contact with most international organizations including the GATT, which it regarded as instruments of imperialist governments.[42] The world environment was hostile to China. The hostility of political isolation started with the Korean War which involved UN troops headed by the U.S.; followed by years of an economic embargo from the West, and finally ending with an ideological dispute and border clashes with the Soviet Union. This was a period of non-participation and isolation both in terms of ideology and institution. Influenced by the old Marxist-Leninist ideology, China rejected both the principles of the multilateral trading order and its institutions on the grounds that they did not serve the proletariat. During this period, China retreated to its own autarkic cocoon with only limited trade with the Soviet Bloc in the first half of this period. China became even more secluded after the so-called cultural revolution broke out in 1966.

The third stage saw China re-enter the international platform by first restoring its legal seat at the United Nations and its subsidiary committees in 1971. With the restoration of its seat at the UN., China also was poised to regain its seats in the IMF and the World Bank. In the same year, the GATT disqualified the Nationalists as a GATT observer, which paved the way for the People's Republic of China to re-establish relations with GATT.[43] During this stage which ranges from 1971 to 1979, Communist China scored quite a few diplomatic victories over the Nationalists. It re-established diplomatic relations first with Canada, the first major industrial country that broke ties with the Nationalists in 1971, then with Japan in 1972 and finally with the U.S. in 1979. The re-establishment of diplomatic relations with those countries has greatly strengthened China's position in the world community and at the same time revitalized China's interest in the outside world. This third stage was especially important not only because China finally got out of the post-war isolation, but also because the world community started to realize China's importance in world politics. During this period, China

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[41] Kock, *International Trade Policy and the GATT 1947-1967*, 1969, p38.

[42] Chen, Dezhao, "China and the GATT", in *Australian Outlook*, Vol. 43, April 1989, pp41-43.

[43] *Beijing Review* No. 10, 1986, p5.

resumed its participation in various world organizations. This participation broadened China's scope in world affairs and increased its activities in world trade. For example, Sino-US trade was just $12.88 million in 1972 when they started direct trade and grew to $2.4 billion by 1979. This period can be classified as one of limited participation when China still had doubt over the multilateral trading principles and the GATT institutions. This will be discussed further in the next chapter.

The last stage witnesses a change in both ideas and approach as China is now poised for full participation in the multilateral trade regime. This stage started in 1979 when China adopted the policy of opening to the world and decided to reform its domestic economic structure and promote export-led growth. From then on, China has stepped up its foreign trade activities with the establishment of bilateral trade relations with more than 170 countries and regions around the world. With 85 per cent of its trade volume conducted with members of the GATT, China is acutely aware that its interest will be better protected under multilateral trade agreements and principles. The most-favored nation treatment of GATT is more favorable to the development of trade between China and other countries than that of bilateral trade agreements. China has finally turned around and is willing to participate in GATT activities.

These four stages can serve as a general categorization of the development of China's relations with the GATT, but this classification cannot adequately explain the real problems facing both China and the GATT organization regarding China's attempt to resume its seat in the organization. Further explanations are required to understand the nature of the problems.

1.4.2. The Ideological Change

The problems started with the change of governments in China in 1949 when the People's Republic of China was established after the Communists defeated the Nationalist government in a civil war. The Communists brought with them the imported ideology of Marxism and Leninism coupled with traditional Chinese feudalistic views and practices. As the country changed from a semi-colonial and semi-feudal society under the Nationalists into a socialist one, profound changes occurred. One of the basic changes was in the ownership of the means of production. According to Marxist and Leninist ideas, ownership in a socialist state should be transferred to the people represented by the state. The shift of ownership from private capitalists to the people brought fundamental changes in planning, manufacturing and consuming of goods and services. The state, acting as the representative of the people, naturally assumes all management responsibilities. Under such a socialist system, everything is supposed to run smoothly because there should be no fundamental conflicts between capital and labor as in a capitalist society. State-owned (which in theory is collectively

owned by the people) and state-run enterprises which base their production according to state planning are naturally the best enterprises in any society. Revolution is regarded as the greatest liberator of forces of production. Thus socialist countries such as China should be able to prove themselves as the fastest growing economies in the world. This results in a series of radical movements, such as land reforms and rectification of the capitalists in the late 40s and 50s, in China to ensure that the state, or representatives of the state at the provincial or local levels, gradually becomes a majority owner of most industries, services and land. Central economic planning has been endorsed in socialist construction and economic development in order to achieve the greatest growth. Foreign trade was monopolized by the state and its specially appointed agencies, and state-planned import and export quotas were handed out to state-owned enterprises. In a word, a centrally-planned economic system was set up to carry out economic goals in China.

This system, however, has been greatly challenged for both political and economic reasons. Politically, the system lost its mentor in 1976 with Mao's death. After his death, the so-called "gang of four" including Mao's widow were purged and later stood public trial for "crimes against the state." The purge and subsequent trial initiated a rectification of the party period in which party members loyal to Mao's ideology and policies were criticized. The rise and consolidation of Deng Xiaoping's position as China's paramount leader brought an army of new cadres with more liberal ideas into important positions in the party and the government. This change of guard in China, though sometimes done in a cutthroat manner, has created a new political situation where a newer breed of communist party cadres, many of them being technocrats, see the inevitability of reforms in China. Despite the troubles Deng has had in selecting his own successor, the party as a whole has been transformed into a more liberal and pro-reform political organization. Meanwhile, the political pressure inside the party for more reforms also grows due to the fact that the old ideology has been unable to realize the economic miracles that were projected in socialist countries.

Economically, China has tested reforms for more than a decade, and the result was encouraging. By abandoning the old ideology and introducing a series of new measures, China's economic reforms create miracles that have not been seen before in the country. The stage of the reforms has gone so far that it is difficult to revert their course, but certainly not impossible. We will discuss further the aspects of China's economic reforms in the next Chapter.

1.5. Summary and Conclusions

Fundamentally, the GATT was created to solve trading problems among market economies after the Second World War. It was not meant to deal with state trading countries with centrally planned economies. However, during its 45 years existence, GATT had to engage countries without market

economies and accept them as full members in the multilateral trade organization. These countries are the former East European socialist countries which eventually joined the Contracting Parties on different terms and in spite of their individual idiosyncrasy in domestic economic structure. The models of Czechoslovakia, Yugoslavia, Hungary and Poland and Romania offer China examples to follow in its bid to rejoin the GATT.

Even though China differs in many ways from those former socialist countries in its historical relations with the GATT organization and its international influences due to its size and culture, the biggest problem that China faces in its endeavor to re-enter the General Agreement is still its lingering structure of centrally planned economy. To solve this problem, China needs to change its economic structure and decentralize its economy so that a market economy could be established in China, which will eventually allow China to participate in GATT as a full member. Reforms in China since the late 70's have substantially paved the way for China to rejoin the GATT, but some fine tuning needs to be done in China's rapprochement with other GATT members. We will look at China's economic reforms in the next chapter to exam how China has changed its economic structure and consider what preparation China has made in the economic system to position itself to rejoin the GATT.

Chapter Two

Reforms: Preparations for GATT Entrance

Rarely does history witness the revitalization of an old country with over 5,000 years of known history and culture. Chances are even slimmer when this country happens to be the largest in the world with over a billion people. China is a country going through such a revitalization process. Since the end of the Maoist era, a great transformation has taken place in China that the world cannot help but to watch in almost disbelief that changes of such magnitude could happen in just a dozen years. These changes, coupled with the collapse of the communist world, will have a lasting impact on Chinese politics and economy. China now has embarked on a new political and economic course which has reached a point of no-return. Politically, ideological controls have been loosened and new ideas other than traditional communist ones are allowed to be discussed and explored as long as they work. Deng Xiaoping's pragmatic "cat theory"[1] seems to have flourished, supported with considerable economic success. Economically, getting rid of some of state-owned and state-run enterprises and reforms in economic structure have propelled China's economy into high gear that out-paces the economic development of many industrialized and newly industrialized countries. The Chinese economy has become one of the few bright spots in today's world that has been plagued by recession.

As the most populous country and one of the largest potential markets in the world, China's transformation has had a great impact on world trade and international relations. China has grown to become a major trading partner to Japan, the United States and the European Community in the past decade and become a major power in world affairs. It is only natural for China to participate in the world's major political as well as economic activities. Full membership in the GATT would complete China's involvement in the world's keystone economic organizations.

China's full participation in the GATT, however, depends very much on further reforms to China's economic structure, including transformation of its foreign trade regime and the abolition of state trading practices. It also depends on China's continued movement toward a market based economy. Reforms in the past decade have laid a foundation for China to transform its economy from a centrally controlled economy into a market one. Many of the factors that prevented China from full participation in the GATT have been eliminated and elements of a market-based economy have sprung up from the vast soil of China. This chapter will study China's reforms in both the political and economic realms in the past decade and examine how the

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[1] Deng's famous motto is that it does not matter if a cat is black or white, as long as it catches mice, it is a good cat.

change of political atmosphere creates a favorable economic environment in which a market economy develops and flourishes. In addition, this chapter will also look at the transformation of China's economic structure: how state-owned enterprises fare in the reform and how private enterprises develop in the process. It intends to argue that recent reforms in China have greatly changed China's political beliefs and economic structures and that further continued reforms will prepare China for a full participation in GATT.

2.1. Prelude to the Economic Reform

Changes in political ideology ushered in economic reforms in China when Deng Xiaoping re-emerged as a powerful figure in Chinese politics in 1977. His position was consolidated as the paramount leader in China at the Third Plenary Session of the 11th Central Committee of the Chinese Communist Party in 1978 . Since Deng's re-emergence, there have been fundamental changes in political ideology. These changes are the prelude to economic reforms. The loosening-up of the ideological grip had two phases: the first was to question Mao Zedong's god-like status; the second was to get rid of the socialist egalitarian system. Both phases were quite successful in "emancipating people's mind" from Maoist ideas, which had been the only standard for the Chinese people after the revolution, and in preparing the ideological bases for economic reforms.

The first phase started in the late 70s and was a movement to persuade people that practice is the only standard to test truth. Before Deng had succeeded in taking over power, Mao's successor Hua Guo-feng, hand-picked by Mao after Deng was out of favor in 1975, had insisted that the Chinese people and the Chinese Communist Party "do as Chairman Mao did" and "say as Chairman Mao said." Hua insisted on two "whatevers": whatever Chairman Mao had said was truth and whatever Chairman Mao had done was correct. Mao's influence at that time was still omnipresent and had not been challenged. In order to get rid of Mao's ghost and consolidate his own position, Deng Xiaoping started a campaign with Hu Yaopang on the front stage as his chief lieutenant, and by using Mao's own word that all so-called truth should be tested only by practice and not anything else.[2] This campaign was aimed at Hua Guo-feng's claim that all that Mao had done was right and all that Mao had said was not supposed to be changed. The purpose of the "truth" campaign was to help people realize that Mao was in fact not a God and that he had made mistakes himself since he was also a human being. On the other hand, it would assist Deng to consolidate his position in China by disclaiming Mao's choice of successor as well as his policies. The "truth" campaign was important not only because Deng wanted finally to get out of Mao's shadow but also because it was the first major movement that Deng Xiaoping orchestrated to begin his era. This first phase proved very successful

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[2] See "On Practice" in *Selected Works of Mao Tse-tung*, Vol.I, 1977, pp259-73.

in unmasking Mao's deified status among the Chinese people and in challenging Mao's ideas. It was also fruitful in opening people's minds to new ideas and methods. Thanks to the vigorous promotion of Hu Yaobang, Deng's first phase in introducing new ideas to people's mind was a big step away from Maoist dogma.

The second phase in changing political ideology was to challenge the long-held communist belief that in a socialist country there should be egalitarianism among people and that every body should be equally poor or rich. Egalitarianism, especially economic equality among people, was one of the basic principles of communism exalted by Marx, Lenin and Mao. It has been one of the cornerstones of the Marxist socialist theory. This results in people's irresponsibility in their work and inefficiency in production in the countries which claimed to be socialist. Under the egalitarian system, there is no economic incentive for anybody to do better or get richer. Economic inequality among people during the Maoist period would be unthinkable and any such action that might make someone richer than others would be severely criticized and branded as bourgeois capitalism. Deng Xiaoping himself was criticized by Mao as a "capitalist roader" during the cultural revolution when the former advocated his "cat theory" which practically threatened socialist economic egalitarianism.

Deng's famous sentences were: It does not matter what color a cat is. As long as it catches mice, it's a good cat. His "cat theory" broke through the shackles of the old egalitarian ideology and moved him away from the commonly-held communist beliefs. It also freed the Chinese people from the egalitarian concepts that had been vehemently advocated and sincerely pursued in all political movements since the Communists took over power in China. Deng began to propagate the idea of "some people can get richer first" in late 1970s which resulted in mushrooming of an army of "*Ge-Ti-Hu*" (private households) - street peddlers - who sell clothes, shoes, jewelry and other things, many of whom were unemployed youths and school dropouts. The "getting rich" idea also affected peasants, factory workers and some government employees. Peasants started to privatize land and went back to individual farming after the dismantling of the people's communes. Workers began a responsibility system under which each worker was responsible for the work he/she had performed, which broke the old "big pot of rice" (*Da Guo Fan*)[3] system and signaled the beginning of the end of the "iron-rice-bowl" (*Tie Fan Wan*) system in enterprises. Under the "iron-rice-bowl" system, workers are guaranteed job security, health care services and housing unless they committed a serious crime that warrants an arrest. Government employees went to find moonlighting jobs which would pay

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[3] "Big pot rice" is a saying in China about the old egalitarian system under which every worker could keep his/her job and would have the same compensation whether or not he/she contributes to the job.

more money than their regular salary. As a result of the abandoning of the egalitarian doctrine, fundamental changes in areas such as housing and food price, transportation and medicare took place in China. All these changes have shaken the root of the Chinese socialist system as CBC's Patrick Brown observed: "Chinese leaders claim that they are building a socialist country with Chinese characteristics. But in fact China appears to be a country without socialism."[4] With or without socialism, the successful story is that the Chinese economy has soared after breaking away from Maoist doctrine and socialist ideology. Its GNP jumped from 358.8 billion yuan in 1978 to 1,975.9 billion yuan in 1991.[5] Economic reform is changing the face of China rapidly.

2.2. The Rural Reforms

Due to the nature of Chinese demography, the rural population, which accounts for 80 per cent of China's 1.2 billion people, is one of the most important and integral parts of any Chinese revolution. The Chinese communist revolution was fundamentally a peasant revolution with socialist characteristics. One of the basic principles and major practices of the Chinese revolution under Mao was to mobilize peasants, set up revolutionary bases in the countryside and then move from the countryside to major cities. Since the success of the revolution, agriculture has always been accorded high priority because of the crucial importance of food availability to political and social stability. As a result, Mao always emphasized the importance of grain production and stressed that, regardless of comparative advantage, every rural area should place the highest priority on the cultivation of grain. After he consolidated his paramount leadership position in China, Deng Xiaoping began to emphasize political stability and economic development. He also realized the importance of the peasants in China. In his speech in June, 1984, Deng said:

> We must first of all solve the problem of the countryside, which contains 80 per cent of the population. China's stability depends on the stability of the countryside with this 80 per cent - this is the reality of China from which we proceed. No matter how successful our work in the cities is, it won't mean much without the stable base of the countryside. Therefore, we must first of all solve the problem of the countryside by invigorating the economy and adopting an open policy so as to bring the initiative of 80 per cent of the population into full play.[6]

The initiative of the peasants was indeed brought into full play when the reform in the countryside began in the late 1970s. Three major measures in rural reform can be credited for the profound changes in the countryside.

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[4] CBC News, April 20, 1992.

[5] World Bank, *International financial Statistics Yearbook*, 1992, p281.

[6] *Major Documents of the People's Republic of China*, 1991, p4.

The first of these measures is the introduction of the household responsibility system, which has by and large reformed China's rural structure. The second measure is the development of diversified undertakings in rural areas which has transformed the life of peasants in China's countryside. And the third is the changes in the way the state promotes grain production and its policies in procuring grain products.

First, China's rural reforms started with the introduction of the household responsibility system. By de-collectivizing agricultural production, China abolished its people's commune system and returned the land to individual family farming under the "household responsibility system". The introduction of the household responsibility system was the most notable reform measure in rural areas. First, this system demolished the old organization in the countryside, effectively permitted the abolition of the communes, and transferred the administrative functions such as public security bureau, public health, education and civil affairs from the communes to newly established township and village governments. Secondly, the responsibility system successfully transformed agricultural production from a collective to a private undertaking by allocating land to peasant families. This has restored an old direct relationship between land and its people. Under the responsibility system, individual families farm, instead of own, the plots of land assigned to them. Peasant families themselves are supposed to pay their share of agricultural tax to the government and to meet production quotas. In turn, they have the right to freely dispose whatever is left over the quotas.[7] Thirdly, beginning in 1978, various kinds of responsibility system, like the household responsibility system, were being experimented with to reform and to diversify the structure of the rural economy. Through the introduction and implementation of such responsibility system, China's rural life has been changed profoundly.

The second important measure of rural reform is the development of diversified rural economy. In 1981, the Communist Party of China (CPC) and the State Council jointly approved a report by the State Agricultural Commission to develop diversified undertakings in the countryside, in which it emphasizes that "diversified undertakings and all-round development should be taken as a strategic measure for bringing about a prosperous rural economy."[8] Under such a measure, peasant families are now permitted to abandon grain and vegetable cultivation to engage in more specialized occupation. Peasants who would not want to do farming could contract their land to others. As a result, some families are now involved in private and collective industry, others provide rural services such as grocery stores and restaurants, still others offer transportation and the use of agricultural machinery that are needed. Peasants abandoning farming to do

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[7] Harry Harding, *China's Second Revolution*, 1987, pp101-7.

[8] *Major Documents of the People's Republic of China*. 1991, p114.

other non-agricultural businesses have fundamentally changed China's countryside and promoted new growth in rural area. It has also changed peasants' mind by ushering in new opportunities other than farming. This diversification has not only helped absorb the surplus labor, due to population growth, and greater productivity, but has also introduced new ideas to peasants. From Table 2.1 below, we can see the scale of these changes:

Table 2.1 Number and Employment of Registered Households Individually Running Non-Agricultural Businesses[9]

Non-Agricultural Households in Countryside (1,000)

	1981	1985	1986	1987
Total Number of Households	961	8916	9201	10342
Total Employment	1219	13823	14383	16660
Industry				
Number of Households	125	1249	1262	1467
Employment	172	2549	2684	3436
Commerce				
Number of Households	380	4645	4809	5400
Employment	446	6363	6640	7597
Food Services				
Number of Households	186	771	810	890
Employment	277	1393	1489	1677
Transportation				
Number of Households	8	881	900	1116
Employment	10	399	1389	1640
Other				
Number of Households	262	1370	1420	1469
Employment	314	2119	2181	2309

By the mid 1980s, agricultural reform was a resounding success. Agricultural output increased from an annual average of about 4 per cent during 1971-78 to about 13 per cent during 1982-86.[10] Total output of rural society has almost quadrupled from 279.212 billion yuan in 1980 to 943.161

[9] William Liu, *China Rural Statistics 1988*, 1988, p10.

[10] Hartland-Thundberg, *China, Hong Kong , Taiwan and the World Trading System, 1990*, p32.

billion yuan in 1987[11]. Table 2.2 shows output of major areas of the rural society:

Table 2.2 Total output value of rural society and its composition[12]

(1,000,000,000 yuan)	1980		1987	
	Value	Percentage	Value	Percentage
Gross Output of Agriculture	192.3	68.9	467.57	49.6
Gross Output of Rural Industry	54.39	19.5	328.48	34.8
Gross Output of Rural Construction	17.99	6.4	72.33	7.7
Gross Output of Rural Transportation	4.71	1.7	33.44	3.5
Gross Output of Rural Commerce	9.84	3.5	41.32	4.4
Total Output Value	279.2	100	943.16	100

However, Chinese leaders have never forgotten the old Chinese saying that "grain is heaven for the people." In both 1981 and 1983, the party and the state emphasized grain production: "Keep a firm grip on grain production while developing diversified economy - this is our principle."[13] This principle has cost the government dearly, and the achievements of the rural reforms came at a price. One of the prices that the state paid in the earlier stage of the rural reforms is the increased procurement prices for grains in 1979-80, which proved to be one of the most effective agricultural reforms. In 1979-80 alone, the procurement price increased almost 40 per cent. The state was paying a higher price to peasants for agricultural products than it was selling to the urban consumers. Consequently, state subsidies for agricultural products increased rapidly, and by 1981 had already cost one quarter of all state revenues for the year.[14] By 1985, the state introduced new measures to procure agricultural products. The new method was a kind of procurement contract that the state offered to peasants to purchase their products, mainly grain, cotton and other important industrial crops. Under the new system, the state would not issue compulsory quotas to peasants and the latter would be free to choose whatever market they wanted to enter. This resulted in a decrease in grain production from a record high of 407 metric tons in 1984 to 379 metric tons in 1985, a drop of 6 per cent. Alarmed Chinese leaders quickly introduced remedial measures to prop up grain production by increasing incentives to peasants who grow grain under contract to the state. The

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11 Liu, *China Rural Statistics 1988*, 1988, p13.

12 Ibid., p13.

13 *Major Documents of the People's Republic of China*. 1991, p112.

14 Harding, *China's Second Revolution*, 1987, pp101-7.

incentives include offering tax reductions, provide low interest loans and allocate scarcely available fertilizer and diesel to peasants who were willing to sign contracts with the state to grow grain. These remedial measures apparently worked to a certain extent. Grain production in 1986 increased to 391 metric tons and continued to swell to 404 metric tons in 1987.[15]

With agricultural reform progress, new measures based on market forces have been experimented with recently in over 400 counties in China. The state has, to a degree, stopped the procurement contract practice in the countryside and allowed peasants to sell their grain at market prices. However, on the other hand, the state imposes an agricultural tax that can be paid in the form of grain products. In some areas, the state charges an irrigation fee which also can be delivered in the form of grain product. To avoid grain price volatility, the state has set up grain reservoirs at the county level and provided subsidies to urban people to ease the possible shock of a grain price hike. According to the "People's Daily", these experiments are quite successful in changing the agricultural infrastructure, reducing state subsidies to agriculture, easing state revenue and promoting grain production and diversification.[16]

Rural reforms in the past decade have greatly improved peoples' lives, especially those who live in the countryside. The per capita income of the peasants increased to 708 yuan in 1991 from 164 yuan in 1978.[17] These changes have provided a base for further reforms in the countryside as well as in urban areas. The household responsibility system, undoubtedly the most effective reform method, has fundamentally demolished collective farming under the people's commune system in China's countryside. This system later has expanded to other areas such as industry and commerce. Diversification in the rural area has transformed a monotonous agricultural life of grain production into vigorous and vital undertakings. Nevertheless, grain production is still one of the most important businesses of the countryside and has given a high priority by the state. The state has been experimenting with the use of a combination of procurement contract and market forces to promote grain production and to increase productivity. The result of rural reforms will ultimately determine the success or failure of the whole reform process in China and, thus, have a decisive impact on China's effort to enter the world economy. With the first successful reform results from the countryside, the state went on to test reform in urban areas by first setting up Special Economic Zones.

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[15] Liu, *China Rural Statistics 1988*, 1988, p43.

[16] *People's Daily* (Overseas Edition), September 29, 1992, p2.

[17] Ibid., October 14, 1992, p4.

2.3. The Special Economic Zones

Unlike the rural reforms which had been carried out rapidly and on a large scale, China has been more prudent with urban reform experiment because urban reforms are not as easy as the rural ones. To experiment with urban reforms, China first set up some development zones to test reform ideas in urban areas in 1979. Meanwhile, China also underwent legal and political reforms to ease the way for foreign investment as part of the urban reform efforts in China. As a direct result of this effort, a number of geographical areas have been designated as experimental focal points to experiment with urban reforms and to attract investments. These areas consist of three layers of "open development" zones: Special Economic Zones (SEZs), open coastal cities, and other special areas that have been granted favorable policies to invite foreign investment and technology. In 1979, four SEZs were established in southern China's Guangdong and Fujian provinces to be the core of the experiment for development and open door policies, which we will focus our discussions on later. These four SEZs are Shenzhen, Zhuhai, Shantou (in Guangdong) and Xiamen (in Fujian). A fifth SEZ - Hainan Province was added to the list in 1988. In 1984, the core expanded to the second layer, i.e. the economic and technical development zones which consist of 14 coastal cities. These cities were offered similar concessions to the SEZs, but were not provided with the same level of government funding for infrastructure development. The third layer of open zones are a number of other areas which have not been designated as development focal points, that have special concessions and government funding for infrastructure development, but still want to have faster development by creating opportunities for investment and joint ventures. They are usually larger economic regions such as the delta regions of the Yangtse River and the Zhujiang River. The development of these special economic zones have not only offered China a window for looking at the outside world, but also provided laboratories for China to test market economy policies, which is of great importance if China wants to do business in the world.

Deng Xiaoping once said: "Special Economic Zones can serve as a window. It is a window for technology, for management, for knowledge and for foreign trade policies."[18] The establishment of the SEZs represented a major attempt to attract foreign capital investment, management skills and technology. The purpose is to create specially controlled environments in which government offers a range of financial, legal and infrastructure inducements to foreign investors. China's SEZs are modeled after those export-processing zones elsewhere in the Third World countries and areas such as South Korea, Taiwan and Singapore where an export-oriented

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[18] Ibid., "The Great Experiment of China's Economic Reforms", February 10, 1992, p4.

industrialization strategy is facilitated by providing legislative and tax concessions, infrastructure and service sites.

However, China's SEZs are different from those export-processing zones in other countries in several ways. First of all, the economic performance of the SEZs has been quite successful statistically, yet initially two-thirds of their output, much of it demanding import components,[19] was marketed in China rather than exported to other countries as was intended. As a result, SEZs served more as import booths than as export-processing zones. This situation has finally been changed. According to a recent People's Daily report, the SEZs now export 60 per cent of their total industrial products to other countries.[20] Second, China's SEZs are test laboratories for a market economy in China. Take Shenzhen for example. It is the largest SEZ beside Hainan and the first to be designated as a special economic zone. It has progressed towards a market economy further than any other part of China with new wage systems, hiring system and labor regulations.[21] Their economic development has been based mostly on the principle of supply and demand rather than political mobilization and central planning. Unlike export processing zones in other countries, the third difference of China's SEZs is that they have been utilized as social laboratories for some Western ideas and cultures. With foreign capital, investment, management skills and technology, the SEZs also import ideas that are new to the Chinese masses. The foreign ideological and cultural influences did raise the anxiety and apprehension of some hard-line leaders in Beijing but it was suppressed by Deng Xiaoping and other reform-minded leaders. Finally, China's SEZs also have to shoulder the task of serving as a front line for the country's reunification attempt. Geographically speaking, the SEZs are neighbors of Hong Kong, Macao and Taiwan. The Shenzhen special economic zone is situated just opposite of Hong Kong, which is due revert to China's control in 1997. Zhuhai is adjacent to Macao, a Portuguese colony which also will return to China by the end of the century. Xiamen, the only SEZ outside Guangdong, is located near Taiwan just across the Taiwan Strait. Nevertheless, the main purpose of those SEZs is to experiment on new ways to obtain faster economic growth through attracting and absorbing foreign investment and expertise.

These experiments proved to be successful as the SEZs grew to be one of the most important parts of the Chinese economy and have provided an example of economic reform for the rest of the country to follow. Since 1985, industrial output has been growing at an unprecedented rate. The industrial

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19 Many products of the SEZs are high-tech products which required imported key component parts, such as screens for color TV sets, major IC chips for computers and mechanical parts in stereo sets, etc. in earlier stage. With the development of China's own high-tech industries, it can manufacture many of the component parts in China now.

20 *People's Daily* (Overseas Edition), February 10, 1992, p4.

21 Harding, *China's Second Revolution*, 1987, p165.

output for the four original SEZs was 4.5 billion yuan in 1985; it increased to 6.78 billion in 1986, a 39 per cent increase; and it reached 10 billion in 1987. Two years later in 1989, it was 20.14 billion and by 1990, the total industrial output of those SEZs topped 20.86 billion, a 5.8 time increase over that of 1985. Economic growth increased at an annual rate of 30 per cent in the past ten years. In addition, the five SEZs signed more than 6600 investment contracts with foreign companies and attracted a total of over US $12 billion in foreign investments in the past decade, roughly one quarter of total foreign investments in China. However, compared with the foreign investments used in the period, the SEZs' export total only amounted to one-ninth of the country's export.[22] Nevertheless, the development process of the SEZs offers China a lesson in economic reform. Apart from government infusion of the infrastructure development in the first stages, the SEZs borrow foreign management expertise and adopt the principle of a market economy. The way the SEZs were created was out of the ordinary, and the economic reforms in the SEZs are even more profound. Clearly it is a total break from the centrally controlled economic model of Communist China under Mao. Among those reforms that have changed the faces of the SEZs are: pricing of products based on supply and demand and according to market activity; open tender for construction contracts; contractual labor rather than assigned jobs; using bank loans for infrastructure development instead of state funding; and establishing foreign exchange centers and foreign investment management companies to allocate foreign currencies according to market values. Measures have also been taken to open a market for real estate by commercializing housing and auctioning land, touching one of the most basic foundations of the centrally planned economy. In 1990, Shenzhen opened its own stock exchange and furthered reforms in the banking and financial system.

The experience of the SEZs is important to the Chinese leaders who pursue reform policies. During the course of the development of those SEZs, there have been quite a few political confrontations between reform-minded and conservative leaders. The degree of success of the SEZs and their function in China's economic reform will be tested and determined in the years to come. However, one thing is certain. The SEZs are an important part of the Chinese reforms which have a great impact on China's entry into the world community. Apart from building a modern physical infrastructure, providing a well-trained labor force and offering preferential tax rates, exemptions and holidays to attract foreign capital, investments and managerial expertise, the SEZs as H. Harding summarizes are unique:

> They are bridges linking China to Hong Kong and Macao, through them to the rest of the world; laboratories in which new management techniques and economic policies can be tested

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[22] *People's Daily* (Overseas Edition), February 10, 1992. p1.

before being adopted in the rest of China; filters that can screen out those aspects of foreign technology and culture that are not considered appropriate for Chinese needs; and lubricants that can facilitate the reunification of Hong Kong, Macao, and, Peking hopes, Taiwan, with the rest of the Chinese mainland.[23]

2.4. The Urban Reforms

In order to carry out the ambitious goal of China's four modernizations,[24] urban economic reforms became the next stage of the reform movement after the success of agricultural reforms in the countryside and the experimental experience of the Special Economic Zones. In October, 1984, the CPC Central Committee adopted a decision on reform of the economic structure and called for restructuring China's entire national economy with a focus on the urban economy.[25] Unlike the rural reforms that swept quickly and successfully throughout China's countryside, urban reforms, a more difficult and comprehensive task, moved more cautiously, affected a wider spectrum of Chinese economy and touched some key issues of socialist economic principles. China's urban reforms include giving more autonomy to enterprises, allowing a diversification of ownership of enterprises, reforming financial systems and gradually abandoning an irrational pricing system so as to create an environment where a market economy can develop.

First of all, the reforms of enterprise autonomy announced in the early 1980's pioneered China's urban reforms and challenged the basis of a centrally planned economy. On the one hand, the enterprise reforms have changed one of the basic Maoist principles - that the leadership of the communist party in enterprises could not be challenged and that the omnipotent party leadership should be in every level of management. On the other hand, enterprises themselves are directly responsible for their profits and losses through the work of managers or factory directors rather than rely on state subsidy or party and government intervention. Originally introduced in Sichuan, one of the largest provinces with over 100 million people in China's southwest, these reforms were officially carried out in over 6,600 enterprises in 1984, accounting for 60 per cent of total output value.[26] Based on the experience of Sichuan, the CPC Central Committee and the State Council promulgated three documents of regulations concerning state-owned industrial enterprises in September, 1986. These documents deal with a), the responsibility of factory directors; b), functions of the party organizations in

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[23] Harding, *China's Second Revolution*, 1987, p164.

[24] The four modernizations were first advocated by late Premier Zhou En-lai in 1975. They are modernization of agriculture, industry, national defence and science and technology.

[25] *Major Documents of the PRC*. 1991, p396.

[26] J. R. Woetzel, *China's Economic Opening to the Outside World*, 1989, p84.

enterprises and c), regulations on workers' congress. The party circular outlines the reform in state-owned industrial enterprises by introducing

> in the enterprise a system under which the factory director assumes full responsibility in production, management and administrative work; to define that the focus of work of party organizations of the enterprise is to guarantee and supervise the implementation of the various principles and policies of the party and the state and to make a success of the party's ideological, organizational and political work in the enterprise; and to further improve the system of workers' congress in examining major policy decisions of the enterprise, supervising the work of administrative leaders and safeguarding the legitimate rights and interests of workers.[27]

In addition to separating the functions of the party from the responsibilities of factory directors, more decentralization measures were adopted which required governments at all levels to serve the enterprises rather than interfere with their operations or make enterprises completely dependent upon them. However, reforms of enterprise autonomy met with certain problems. For example, both the party and the government bureaucracies have tenaciously maintained their control over state enterprises. Many government agencies have simply transformed themselves into state corporations which oversee their factories. They also have control over utilities and raw materials allocated by the state with which they can subject factory managers to comply with their wishes and demands. As a result, factory directors/managers have not received the powers to which regulations have entitled them.

Despite the problems, since 1981 China's urban economic structure has been transformed into one of different ownerships. The urban economy, encouraged by the government, has been greatly diversified, with state-owned enterprises playing a reduced role and collectively and privately owned enterprises assuming larger functions. The total output of state-owned enterprises dropped from 78.3 per cent of China's total industrial output in 1981 to 55 per cent in 1991; industrial output of the collectively owned enterprises jumped from 21 per cent in the same year to 35 per cent in 1991, and the output of privately-owned enterprises including those owned by foreign firms and joint ventures increased from a mere 0.7 per cent a decade ago to over 10 per cent today.[28] The development of a private economy is the biggest change in China's economic structure and has altered the nature of China's so-called socialist economy by challenging the fundamental principle of a centrally planned economy that all means of production are owned by the people through the apparatus of the state. The total number of private

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[27] *Major Documents of the PRC*, 1991, p559.

[28] *People's Daily* (Overseas Edition). August 7th, 1992. p1.

enterprises have grown from fewer than 7,000 with an employment of 14,000 people in 1978 to 14.32 million that employ more than 27.38 million people in 1991.[29] The development of the efficient private-owned enterprises provides an opportunity for the government to pursue the experiment of privatizing some state-owned enterprises, especially in Shanghai and Shenzhen where enterprises are sold to the public through share offerings.

Reforms of enterprises have brought about other reforms in restructuring China's economy, notably in the financial and tax system. For example, before the reforms, state-owned enterprises did not have discretionary funds, because they had to submit profits to the state. In return, they got their investment capital from state agencies, upon approval of projects and according to the central planning. The reform of the management of the factories and the responsibility of their directors for the profitability of their investment has given enterprises greater access to financial resources and increased the power of the banks. In addition to changes in the financial system, the state has reformed the tax system in order to better accommodate enterprises' responsibility. Under the new policy, the enterprise instead of handing in profits has to pay taxes to the state, on the grounds that a tax system could more accurately measure, and stimulate the performance of the enterprise. All earnings after tax are at the disposal of the enterprise for re-investment, worker welfare, bonuses, research, or new employment. However, if the enterprise fails in generating a profit, the factory director will be held responsible for any losses in the enterprise. But, usually the most severe punishment for factory director is to loose his/her position. By 1986, the National People's Congress passed a bankruptcy law to allow bankruptcy of Chinese enterprises, and bankruptcy has been practised in selected cities such as Shenyang, China's northern industrial center and Shanghai. But bankruptcy is difficult and can even be unfair, in the absence of labor mobility, and especially irrational pricing system.

Change of the pricing system is another target for urban reforms set by the party and the state. The CPC decision on reform of the economic structure in 1984 realized that "reform of the price system is the key to reform of the entire economic structure."[30] Reforms in the pricing system, especially in the price of means of production, were carried out to correct irrational pricing situations that affected the performance of enterprises. For example, some enterprises earned profits from efficient management, but others made profits from irrational state pricing. By the end of 1970s, the prices of most primary products such as grain, energy, mineral products and raw materials were too low, whereas the prices of manufactured goods, including processed materials such as steel, were set too high[31]. The government's goal is to reform the

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[29] Ibid., August 7th, 1992. p1.

[30] *Major Documents of the PRC*. 1991, p 408.

[31] Harding, *China's Second Revolution*, 1987, p111.

pricing system to better reflect market supply and demand, and to pay attention to economic leverage. The party's decision blamed irrational system of price control and called for reforms to the "over-centralized system of price control" and a gradual reduction of the state's role in setting prices. "Thus prices will respond rather quickly to changes in labour productivity and the regulation between market supply and demand and better meet the needs of national economic development."[32] But it hastened to add that the reform of the price system would affect every household and the national economy as a whole and should be carried out with extreme prudence.[33] Nevertheless, the reform of the pricing system was undertaken rapidly in late 1984 and early 1985, which resulted in an immediate jump in the inflation rate. In 1988 and 1989, a similar situation occurred when the sudden relaxation of government control of pricing together with a loose monetary policy caused the inflation rate to rise over 30 per cent[34].

Despite the inflation problem, with price reform, a freer-enterprise economy has developed. By the mid 1980s, China had established three categories of prices: fixed prices, floating prices and market prices. Fixed prices still exist as China has not totally reformed its price system. In 1987, however, the number of industrial products sold at a fixed price declined from 256 to 29. Consumer goods with state-set prices had fallen from 85 to 37, and agricultural commodities reduced from 113 to 25. Floating prices are also practiced with the state setting up a price range, usually within 20 per cent of the fixed price. And finally, with the relaxation of mandatory planning, factories now are able to sell their output on the open market at a market price.[35] The Chinese government announced further reforms on the pricing system in September, 1992, when it decided to release price control over 593 items, such as oil, steel, iron and other raw materials, and the price of transportation, reducing the number of state-controlled means of production from 737 in 1991 to only 89 in 1992. Besides, the state has also reduced price controls to only 30 items from more than 800 in light industrial and consumer products over the years. In agricultural products, the state retains price control to just 7 basic commodities such as grain, cotton and tobacco.[36] While the actual numbers are difficult to compare and substantiate, the general policy trend is clear. The government has removed a significant number of products from fixed price controls. The reforms in pricing system in the past decade have not only made China's pricing system more rational to reflect a market of supply and demand but also laid a foundation for transforming China's economic structure into a more market oriented one.

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[32] *Major Documents of the PRC*. 1991, p409

[33] Ibid., p409.

[34] P. Van Ness, *Market Reforms in Socialist Societies*, 1989, p294.

[35] Harding, *China's Second Revolution*, 1987, pp111-2.

[36] *People's Daily* (Overseas Edition), September 2nd, 1992, p1.

The development of a market economy in China has gradually become possible after all these years of reform. This is due to the changes in the specific social and historical conditions - such as changes in science and technology; changes in industrial structure; changes in the pricing and tax systems; changes in financial system; and in particular, the closer international linkage among trade, finance and production. As a direct result of those changes in China's economic structure, the 14th CPC congress in October, 1992, adopted a program to make the transition from an administrative economy commanded directly by the central government towards a market economy. This program is also partly based on Deng Xiaoping's comment that a planned economy does not mean that it is socialist economy, whereas market economy does not mean capitalist. Both are economic means because in a capitalist country, there is also planning while in a socialist country, there is also market.[37]

In his report to the CPC's 14th National Congress, party General Secretary Jiang Zhemin announced that China would adopt a socialist market economy. Under the plan, four major tasks would be carried out to make China's economy a market driven one. The first would be to reform management of large or medium state-owned enterprises, which have undergone only very little reform process in the past decade, by allowing more autonomy to those enterprises and by separating management and administration so as to tap vitality and increase economic effectiveness of production and management. It would promote enterprises' development by making them self-responsible for profits and losses without government intervention. Enterprises will be permitted to become legal entities, making them more competitive in an uncontrolled market competition. At the same time, China would further expand the responsibility system in the enterprises, more actively experiment in privatization of state-owned enterprises through share offerings and even encourage formation of major corporations through means of annexation and incorporation. The state would also allow the sale of certain small and medium state-owned enterprises to private ownership. The second task outlined by Jiang calls for a rapid nurturing of a market system, especially by developing markets for commodities and means of production. A nation-wide, open market system would be established to allow development of financial market, real estate market, labor market, information market and technology market so that a rational pricing system in a market economy would be set up to speed up reforms. Third, further reforms in the distribution system and social welfare system would be needed to protect the interests of the state, the enterprise and private citizens. Jiang also urged further reforms to China' taxation system and salary system, giving more authority to enterprises to determine the range of salaries of employees. In addition, he also asked for a social welfare

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[37] Ibid., October 13th, 1992, p1.

system to be established to take care of unemployment, pension, and medicare. The final task would be to change the function of the government. Governments at all levels would separate themselves from enterprises and not intervene in the management of the enterprises. The function of the government would be limited to overall planning, formulating general policies, providing information and services to enterprises and supervising.[38]

The transition to a market economy has not been driven by domestic considerations alone, it is also partly due to China's drive to open to the outside world. This task of opening China to the outside world demands that a complementary relationship be established between China's economic development and that of the rest of the world. As a result, China can realize greater benefits in world trade and from the international division of labor and resource allocation. This opening, or open door policy, is more than a simple utilization of foreign capital, technology and resources; it is also more than the use of foreign markets or the introduction of foreign competition to stimulate the domestic market. Development demands more than just opening, because to develop a strong economy, China's market, resources, and productive capacity would also need to plunge into the world economic flow to create more market and development opportunities. Gradual development of a market economy in China might make China's move into the world economic flow less painful, and allow China realize more benefits from foreign trade, investment and co-operation. A market economy would also enable China to participate in the world economy fully on the basis of similar principles as other countries.

2.5. Summary and Conclusions

The ideological emancipation of the Chinese people after the death of Mao Zedong paved the way for China's economic reforms which first swept the countryside and quickly spread to the cities. Reforms in the past fourteen years, even with problems such as the income gap that has widened among working people and increased inflation that is associated with the changes, have greatly revolutionized people's thinking and considerably bettered the lives of hundreds of thousands Chinese people. With the success in economic reforms, China has better positioned itself to participate fully in GATT.

The reform process has brought changes in economic structure. With the relaxation of state-control over enterprises and the management responsibility system, many facets of the centrally planned economy have been questioned and eliminated. In October, 1992, at the 14th CPC congress, party general secretary Jiang Zemin announced that China would move towards a market based economy and thus set the tone for future economic reforms in China. The development of a market economy in China, partly

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[38] Ibid., October 14th, 1992. p3.

called forth by the demands of economic structural changes from GATT discussions, (which will be dealt with in Chapter 4) will certainly continue to invigorate the Chinese economy and greatly enhance the chance for China to participate fully in world economic affairs. It will also allow China to join the GATT organization under the same principles as other GATT members.

Some of the reform efforts have been directly or indirectly incited by the suggestions raised by the Contracting Parties during the negotiations on China's application to the GATT. For example, the reforms of China's centrally planned economy, the state-controlled pricing system and the tariff structure (discussed later in Chapter 4) all reflect China's intention in moving its economy to a market oriented one and its desire to join the GATT. Reform of the pricing system has dealt a further blow to the centrally planned economy. A more rational pricing system has begun to take shape after the state relaxed price controls over many industrial, agricultural and consumer products. The reformed pricing system is based more on a market reality which reflects supply and demand, and will be in conformity with the principles of GATT.

However, Rome was not built in a day, nor will be the development of a market economy in China. China's reforms still face great uncertainty due to its political structure and the self-proclaimed socialist ideology. Whether China will stay on the course of economic reform still depends, to a certain extent, on who will become the next strongman in China after the death of Deng Xiaoping. Nevertheless, the results of China's reforms in the past decade and its attempt to develop a market economy in the future are promising signs and will strongly advocate China's full participation in world economic affairs and its full membership in GATT. Besides, China needs to use its experience with the other two international financial institutions, namely the World Bank and the International Monetary Fund, to further enhance its position in the attempt to rejoin GATT. In the next chapter, a study of the relations between China and the keystone international organizations will be conducted to see what experience China has learned from participating in the IMF and the World Bank and to exam China's current situation in world trade and economic structures.

Chapter Three

China's Experience with the IMF and the World Bank

Since the mid-70s China has embarked on sweeping policy changes and economic reforms that have both drastically accelerated the pace of China's domestic economic development and fundamentally transformed China's economic relations with the rest of world. China has abandoned the autarkic policies of the Maoist era and witnessed a rapid economic growth and development that has led to increasing integration with the world economic system. In 1980, China joined both the International Monetary Fund and the International Bank for Reconstruction and Development (IBRD, or the World Bank). China's participation in these two institutions has proven to be very beneficial. When China entered the IMF and the World Bank, its gross national product was the eighth largest in the world and the total volume of its foreign trade was US$37.82 billion.[1] After ten years, China's total value in foreign trade has reached US$135.7 billion, making China one of the largest trading countries in the world.[2] However, China's attempt to rejoin the GATT has been somewhat cautious because unlike the IMF and the World Bank, in which China can determine how deeply it will get involved, GATT regulations require members of the organization to be open and transparent in their trading practices. To enter GATT, China not only has to open its books but also change many existing trade rules and institutions in China. Furthermore, China has to make concessions to other GATT members by opening its own market. All these problems cause China to act more cautiously with the resumption of its GATT seat than it did with the IMF and the World Bank.

This chapter will study China's experiences with the two keystone international economic organizations, namely, the IMF and the World Bank. These experiences are important for China to learn to deal with world economic organizations and provide valuable lessons for China in its negotiation with GATT. A study of how China has participated in the IMF and the World Bank will be conducted to understand the domestic and international situations facing China's entrance to the two organizations. An analysis of China's initial contacts and following adjustments with the IMF and the World Bank will made to show China's participation process.

3.1. Initial Contacts

There were four stages in the development process of China's participation in these two international economic organizations. The first stage was between 1971 and 1975 when the two organizations began to open their doors to the People's Republic of China after it regained its seat in the

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[1] Nicholas Lardy, *China's Entry into the World Economy*, 1987, p4.
[2] Li Peng, *the People's Daily*, April 6, 1992, p3.

United Nations in 1971. China's membership in the UN stimulated its interest in the IMF, the World Bank and the GATT, but the domestic political environment in China and the sentiment towards Taiwan in the United States prevented the rapid pursuit of opportunities to form direct contact between China and the IMF and the World Bank.

Opportunities were there for the PRC in both the IMF and the World Bank when China resumed its seat in the UN. Taiwan was not on the executive board of either institution due to the dwindling size of its quota and subscription. Taiwan also was not included in the constituency of any elected executive director starting in 1972 due to its seat loss in the UN. The PRC formally requested both institutions to expel Taiwan but did not express openly the desire to join them immediately. In 1973, World Bank President Robert McNamara cabled Beijing stating that China's application to the World Bank would be welcomed. McNamara thought that without China's participation in the World Bank, it did not deserve its name. However, China did not answer the call, and instead both the Ministry of Finance and the Ministry of Foreign Affairs prepared a report recommending not to participate in both organizations for two reasons. The first reason was that the weighted-voting formula in both the IMF and the World Bank would have limited China's ability to pursue its broader foreign policy objectives. Those objectives were on the one hand to fight against US imperialism and on the other to combat Soviet revisionism. If China had become a member in these two organizations then, it would only have 1.68 per cent of the total votes in the IMF and 2.83 per cent of those in the World Bank. China thought that these voting privileges were too small to make any impact in those two organizations for its broader foreign policy purposes. The second reason was a consideration that the Articles of Agreement of the IMF contradicted principles of China's socialist monetary system, principles that in China must be adhered to. The nature of the IMF and the World Bank was also considered as contradictory to the nature of the Chinese economy which was based on an ideology of self-reliance. And its foreign trade was designed to insulate the Chinese economy from world market forces. If China were to join both institutions, it would be subjected to their regulations and principles which China felt might harm its national interest. Thus during this period, Beijing was reluctant to participate in those international economic organizations.

The second stage ranged between 1975 and 1979 when developments in the IMF finally forced China to take action in order to protect its interests. When a decision was made in 1976 by the IMF to sell a portion of the gold that member states had deposited with the Fund, China was very concerned. Later when the discussion raised the question of whether Taiwan would be considered the claimant for China's share of the gold and the beneficiary of the sale, China acted quickly by asserting that all properties and rights in the IMF belonged to the Chinese people represented by the PRC instead of Taiwan. During this period, China also witnessed fundamental domestic

changes. In the beginning of 1976, Premier Zhou Enlai died and Deng Xiaoping, then vice-premier, was purged. Later in the year, Mao Zedong died. After two years of transition which saw national mourning, elite plotting and power struggles, Deng Xiaoping emerged as the winner and the preeminent leader in China in 1978.

Deng's consolidated position as China's paramount leader provided stability in China's politics and a series of economic development policies were formulated to open China's economy to the outside world. The Third Plenary Session of the Eleventh Central Committee of the Chinese Communist Party was convened in December, 1978 when major decisions were made to carry out economic reforms by changing agricultural policies, introducing personal responsibility system in both industrial and agricultural sectors, bringing up market influences and opening China's market to the world through export and foreign exchange earnings. These decisions prepared domestic readiness for China to formally join the IMF and the World Bank.

Besides domestic preparations, developments in the external environment also favored China's participation in those two institutions. Since the resumption of the PRC's UN seat, sixteen UN bodies other than the IMF and the World Bank had expelled Taiwan. It would be just a matter of time and China's willingness to join the IMF and the World Bank that the two organizations would replace Taiwan with PRC. Furthermore, China and the United States established formal diplomatic relations on January 1st, 1979 at the expense of Taiwan. Under such circumstances, it would be quite unlikely that the Carter Administration would oppose China's participation in the IMF and the World Bank. Thus, both the decisions of the CPC's Third Plenary Session and the external environment set the stage for China's participation in the IMF and the World Bank.

The next stage was the direct contacts and negotiations on actual terms of China's participation. In February, 1979, twenty-one World Bank officials led by David Gordon, director of the Bank's International Development and Finance Department had a two-week private visit to China. In October of that year, China sent its first observer to attend the annual meeting of the boards of governors of the IMF and the World Bank held in Belgrade. The following year saw two important missions by the IMF and the World Bank. The first was led by Tun Thin, Director of IMF's Asia Department and the other headed by McNamara. During the discussions, the Chinese made it clear that Taipei would have to depart in order for Beijing to fill the China seat, a step that the Bank authorities took subsequently. One month after McNamara's visit, on May 15, 1980, the executive board of the World Bank formally decided to accord to the PRC representation in the organization despite

objection from the U.S.[3] The Carter Administration feared that congressional reaction to Taiwan's withdrawal might weaken the ability for the Bank to obtain congressional funding for the Seventh International Development Association Replenishment[4]. However, McNamara felt that the possible China market for the U.S. would instead help attract congressional funding.

3.2. Adjustments

Since becoming a member of both the IMF and the World Bank, China has gone through three phases in its participation in the IMF and the World Bank from initial participation to mutual adjustment and finally mature partnership. China's initial participation in the World Bank included five projects aiming to improve education facilities, modernize harbors, develop agriculture and increase foreign exchange loans[5]. It proved to be very successful. China's early relationship with the IMF was also fruitful. In September, 1980, China secured a special increase in the PRC's quota for Special Drawing Rights (SDR) from SDR 550 million to SDR 1.2 billion. Mutual adjustments took place after the initial participation. Institutionally, both the Bank and the Fund have legitimated their claim to be genuinely global organizations. The World Bank established a China Division and the Chinese sent their representatives to sit on the boards of executive directors of both the IMF and the World Bank. The Chinese executive directors have been very active in both organizations and emerged as spokesmen for developing countries[6].

Meanwhile, great adjustments also took place inside China. The first adjustment was a change in the measurement of economic data. China's old way of compiling data was a reflection of the Soviet and Marxist influence on the economic system. It did not measure GDP and instead measured net material product (NMP). After it joined the IMF and the World Bank, China was asked to provide both organizations with GDP statistics. The Chinese government also had to release information which was not available before due to the condition of IMF membership that required member states to provide trade, currency and credit data. Institutional changes also occurred in China to deal with both the Fund and the Bank. A bureaucratic structure was set up within the Ministry of Finance to manage China's relationship with the World Bank. And departments were also established in the People's Bank

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[3] For a detailed account of the negotiations between China and the IMF and the World Bank, see Jacobson and Oksenberg's *China's Participation in the IMF, the World Bank and GATT*, 1990, pp57-89.

[4] Jacobson and Oksenberg, *China's Participation in the IMF, the World Bank and GATT*, 1990, p79.

[5] For a complete list of the projects, see Jacobson and Oksenberg, *China's Participation in the IMF, the World Bank and GATT*, 1990, Appendix I, p173-75.

[6] Jacobson and Oksenberg, *China's Participation in the IMF, the World Bank and GATT*, 1990, p132.

of China and the Ministry of Foreign Economic Relations and Trade (MOFERT) to handle business with the IMF and the GATT. More importantly, China has realized that these international economic organizations can actually help its development rather than be "just an instrument for capitalism", a concept that it held for a long time during the Maoist era. Both ideological change and reform to its state apparatus to accommodate the changes in policies towards the IMF, the World Bank and the GATT were not only necessary but beneficial to China's economic development.

With adjustments on both sides, the relationship between China and the IMF and the World Bank has matured. The World Bank's total loan to China increases constantly. The total new loan commitments were $600 million in 1983, and they reached $1.1 billion in 1985. In 1988 the Bank's new loan was almost $1.7 million. Taking advice from the IMF, China has also made progress in decentralizing its economy. As a result, the government now has fewer direct instruments of control and has to rely more and more on indirect instruments commonly used in market economies, such as control of monetary supply, interest rates and taxation[7]. With economic reforms in China and the technical assistance and financial help from the IMF and the World Bank, China has sustained an average annual rate of growth in its GDP of over 9.5 per cent during the period of 1980-88[8]; the fastest in the world.

3.3. Summary and Conclusions

Since China adopted its opening to the outside world policies, its foreign trade has more than quintupled. The domestic economic development has led to an inflow of foreign direct investment of over US$3,453 million in 1991 alone[9]. In the past 12 years, China successfully joined the IMF and the World Bank in all of their activities. Dealing with the IMF and the World Bank offers China invaluable experience in its attempt to rejoin GATT, the last keystone international economic organization. China's initial contact with the IMF and the World Bank and the subsequent adjustments have given China confidence to participate in the world economic order established after World War Two.

Participation in the IMF and the World Bank helped China step up reforms to change its domestic economic structure, increased its foreign trade considerably in the past decade and opened its economy to the outside world. It has also opened the eyes of Chinese leaders, who have expressed on many occasions since 1986 their desire for China to resume its seat in the GATT

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[7] See Luc de Wulf and David Goldsbrough, "The Evolving Role of Monetary Policy in China" *IMF staff papers* 33, no.2 (June, 1986) pp209-42.

[8] IBRD, *China Between Plan and Market. A World Bank Country Study.* 1990.

[9] IMF, *1992 International Financial Statistics Yearbook*, 1992, p281.

organization, the last keystone international economic organization. However, China has been more prudent when it comes to view its participation in GATT. This is because GATT is somewhat different from the IMF and the World Bank in which China has some control over how it should participate in their activities and how extensively it should be involved. The negotiation process of China's participation in GATT is also different. The next Chapter will examine this process.

Chapter Four

Negotiations to Join GATT

Economic reforms and the experience with the world's major economic organizations such as the World Bank and the International Monetary Fund have prepared China to resume its membership in the General Agreement on Tariffs and Trade. A further shift to a market oriented economy in China's economic structure will help pave the way for a resumption of its GATT seat in the future. However, unlike the IMF and the World Bank, where China was invited to participate, resumption of China's GATT seat will mean more careful scrutiny of China's trade regime by the international community. Not only would China be obliged to all the regulations of the GATT, but also to open its market for more foreign imports.

But because of the complexity of China's existing economic structure, its great impact on world trade, its enormous potential market, and the size of its economy, China's participation in the GATT still causes concerns for the Contracting Parties and commands careful consideration of the international trade regime. This chapter will look at the concerns of major players in the GATT organization, namely the United States, the European Community and Japan. Emphasis will be laid on the analysis of their attitude towards China's participation in the GATT through the degree of involvement in their trade with and investment in China. Argument will be made to show that their attitudes towards China's participation in GATT depend on their involvement with China, their own trade considerations and their share of the Chinese market.

This chapter will also study China's position in its attempt to rejoin the GATT by looking at the three principles raised by the Chinese during the negotiation process. These principles are: resumption of China's old seat, participation on the basis of tariffs concession and China as a developing country.

4.1. The GATT Difference

Unlike China's participation in the IMF and the World Bank which allows China to have access to advice and funds without giving a lot of concessions, participating in GATT would require China to make certain concessions in exchange for the benefit and privileges it might enjoy as a full member of GATT. In the case of the IMF and the World Bank, China did not have to make substantial changes to its domestic economic structure to benefit. All China had to do was to open its books and release its data which had been held secret, and to decide how much of the available funds China will use under the IMF arrangement. Thus to a great extent China has some

control over how deep it is willing to get involved. However, full participation in GATT would force China to liberalize its trade regime, adopt new rules for foreign trade, and undergo serious reforms to its trade institutions and organizations. As a member of the GATT, China would have to put its trade regime and practice under more scrutiny and surveillance which would certainly make some decision-makers in Beijing frown at such a thought. Despite the possible ramifications, China is still poised to join GATT as a full member because possible benefits out-weight disadvantages. After the experience with the IMF and the World Bank, Beijing envisioned that the resumption of China's GATT seat would give China a number of benefits such as obtaining unconditionally the U.S. most-favored-nation status, attracting more foreign investment, having better access to foreign markets, and being able to participate in GATT talks that might shape the future international economic trade order. However, the examination process for Beijing to become a full GATT member is more complex and difficult than the process of joining the IMF and the World Bank.

The examination process of China's application to the GATT has been different from the process of China's participation in the IMF and the World Bank because in the latter cases, China was invited to join them and the welcome mat had been laid out for China at a time when Beijing was not even ready. In the GATT, however, China has to face careful scrutiny and numerous questions. China formally applied for full membership in the GATT in July, 1986. Six months later in February, 1987, China submitted a memorandum describing its foreign trade regime. This memorandum was prepared under Australian technical assistance and American engagement[1]. Like the IMF and the World Bank, The Contracting Parties established a working group to examine China's application. A year later, China had been presented with more than 1,200 questions, a record number,[2] which China answered by mid-1989. Most questions, submitted by the industrialized countries such as the United States, the European Community and Japan, dealt with concerns that certain aspects of China's trade regime were still not consistent with the GATT framework. Their concerns touched on the pricing mechanism, customs procedures, bilateral trade agreements, and the need for greater transparency in trade regulations.[3] Questions were also raised on China's position to resume its old GATT seat instead of joining as a new member, which posed particular difficulties for Australia, Japan and the United States.[4]

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[1] Jacobson and Oksenberg, *China's Participation in the IMF, the World Bank and GATT*, 1990, pp94-5.

[2] Ibid., p96.

[3] GATT, *Focus*. No. 62. June, 1989, p10.

[4] Jacobson and Oksenberg, China's *Participation in the IMF, the World Bank and GATT*, p95.

The most apprehensive group that has carefully watched the process of China's accession to the GATT are the LDCs. They are concerned about China as a great competitor in Third World markets and for bilateral and multilateral aid funds.[5] The LDCs worry about China's expansion in world trade because they basically share the same labour-intensive products and target similar markets. The apprehension reflects their fear that China's size and potential market for world trade will place them in a less favorable position. Surprisingly however, the LDCs did not supply many questions even though they realize China's competitiveness. Developing country representatives in Geneva have regarded China's full participation as inevitable. They believe that it is just a matter of time before China resumes its seat in the GATT. They have been more curious than concerned about China's positions on issues in the GATT talks.[6] It is not difficult to find answers to the fact that the LDCs were quiet on the question of China's participation in the GATT because from the following tables we can see that most of China's major trading partners are industrialized countries. Table 3.1 and Table 3.2 show China's 14 largest trading partners in the world.

Table 3.1 China's Trade Statistics (Exports)

Exports

(Millions of U.S. Dollars)

World	1986	1987	1988	1989	1990	1991
Total	31,367	39,464	47,663	52,914	64,500	71,986
U.S.	2,633	3,030	3,399	4,414	5,314	6,192
Canada	307	409	390	412	443	555
Australia	209	298	362	423	468	555
Japan	5,079	6,392	8,046	9,395	9,210	10,265
France	321	436	515	528	654	735
Germany	1,011	1,223	1,491	1,609	1,987	2,361
Italy	363	570	746	715	873	932
Netherlands	463	606	749	759	943	1,064
U.K.	1,437	532	659	635	664	729
Hong Kong	9,776	13,764	18,239	21,916	27,163	32,110
Indonesia	143	188	236	223	401	481
S. Korea	---	---	---	---	433	2,177
Singapore	1,217	1,323	1,494	1,692	2,016	2,013
Thailand	159	301	512	500	854	847
U.S.S.R. (former)	1,230	1,247	1,476	1,849	2,048	1,860

[5] Hardland-Thunberg, *China, Hong Kong, Taiwan and the World Trading System* ,1990, p79.

[6] Jacobson and Oksenberg, China's *Participation in the IMF, the World Bank and GATT*, pp83-106.

TABLE 3.2[7] China's Trade Statistics (Imports)

Imports

(Millions of U.S. Dollars)

World	1986	1987	1988	1989	1990	1991
Total	43,247	43,222	55,352	59,140	54,449	63,957
U.S.	4,718	4,836	6,633	7,864	6,591	8,003
Canada	1,012	1,403	1,856	1,078	1,484	1,645
Australia	1,403	1,325	1,113	1,472	1,361	1,555
Japan	12,463	10,087	11,534	10,534	7,656	10,079
France	742	899	987	1.420	1,674	1,590
Germany	3,627	3,129	3,450	3,379	2,899	3,103
Italy	1,141	1,248	1,552	1,835	1,087	1,474
Netherlands	281	231	367	450	400	432
U.K.	1,017	900	898	1,084	1,383	947
Hong Kong	5,572	8,437	12,005	12,540	14,565	17,451
Indonesia	324	591	681	582	849	1,402
S. Korea	---	---	---	---	236	1,065
Singapore	553	618	1,018	1,499	849	1,062
Thailand	287	405	633	756	386	421
U.S.S.R. (former)	1,472	1,291	1,802	2,147	2,213	2,109

Hong Kong, although classified by the World Bank as a "developing country", is China's largest trading partner, followed by Japan, the United States and Germany. Without Hong Kong, China's exports to industrialized countries amount to 35 per cent of total exports in 1992 while imports from those countries accounts for 50 per cent of total imports. China's exports to developing countries, including Hong Kong amounted to 65 per cent in 1992 while imports from the developing countries accounted for 50 per cent. Hong Kong alone accounts for 44 per cent of the exports and 27 per cent of the imports. Thus, nearly 80 per cent of China's total foreign trade was conducted with industrialized countries and Hong Kong while the rest account for only 20 per cent. From these trade figures it is clear why industrialized countries were more concerned about China's participation in GATT.

4.2. Concerns of Major Players of GATT

The industrialized countries trade volumes with China do not explain all their concerns. The industrialized countries have different concerns when they consider China's participation in the GATT. The complexity of China's particular case and its influence in the world have made accepting China as a

[7] IMF, *Direction of Trade Statistics Yearbook*, 1992, pp134-36.

full GATT member more than a mere formality. It seems that most industrial nations at the present do not think the Chinese economy has reached the stage for a full unconditional GATT membership.[8] This assessment has doused China's hope to enter the GATT in 1993.[9] Besides the concern over China's economic structure, Washington, Tokyo and Brussels also have different reasons for concerns of China's full participation in the General Agreement.

4.2.1. The American Concern

One of the most important GATT members who has major concerns over China's accession to the GATT is the United States. As the world anti-communist leader, the U.S. has been reluctant to grant beneficial trade conditions to communist countries. In the case of China's resumption in the GATT, the U.S. is not enthusiastic due to both political and economic considerations. Politically, with the fall of the Soviet empire, China is no longer perceived as a counter weight to the U.S.-Soviet conflict. The Chinese position has weakened somewhat due to the changes in world politics, even though China is still strategically important in the world. In addition, the U.S. is concerned about China's human rights record and Chinese arms sales.[10] Economically, U.S. trade with China only amounts to $10 billion in 1989,[11] far from its trade with the EC, Canada and Japan. What is more, U.S. trade law has created further obstacles for China to get trade benefit from the U.S.. The U.S. only extends MFN rights to non market economy countries for limited periods. MFN rights are renewable annually should that country meet provisions of America's own laws and maintain emigration policies that meet the standards set forth by the laws of the United States. Although the Bush Administration extended MFN treatment to China after the 1989 Tiananmen incident, it does not extend its Generalized System of Preferences (GSP) (i.e. duty free treatment) to China's imports. The 1974 U.S. Trade Act stipulates that such preferences for less developed country exports to the United States could only be accorded to GATT members.[12] By 1980, China had gained GSP treatment from all developed countries that had such schemes except the United States. U.S. law requires that communist countries adhere to GATT principles and be a member of the IMF to receive GSP treatment.[13] The Sino-U.S. trade relations took a down turn when the Bush Administration, mainly for re-election campaign purposes, announced the sale of 160 F-16 fighter jets to Taiwan, which touched the most sensitive issue

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[8] Zarocostas, "Early GATT Entry Unlikely for China, Western Officials Say," *Journal of Commerce* March 3, 1993, p27

[9] Ibid., p28

[10] The Economist, *China and GATT*, March 6th, 1993, p36.

[11] Hartland-Thunberg, *China, Hong Kong, Taiwan and the World Trading System* , 1990, p58

[12] Ibid., p59.

[13] Jacobson & Oksenberg, *China's Participation in the IMF, the World Bank and GATT*, 1990, p93.

of Sino-U.S. relations. As a result of the announcement, China threatened to withdraw from an earlier deal of purchasing automobiles worth of US$160 million from the U.S. and China also warned the United States that it was ready to stop importing U.S. wheat. However China says that the deterioration of Sino-U.S. trade relations should not jeopardize China's bid to resume its GATT seat since "they are two different issues".[14]

During the consultations on China's resumption of GATT membership, the U.S. raised five points regarding China's application. The first was that the U.S. thought that China should have a nationally applied trade policy without discrepancies in customs administration and application of tariff schedule which may vary from time to time and from place to place. To decentralize the economy, China has at the same time lost some of the control over its own export licensing regulations. Domestic competition has given rise to regional and ministerial protectionism.

In the U.S. view, China should also improve the transparency of its trade policies and regulations. Information should be made available to the public. The administration of trade barriers and the foreign trade organizations and the foreign trade plan should be made available as information. The U.S. complained that there are two sets of laws in China - one for the foreigners and the other (neibu-'internal') for themselves, which can override the official regulations. In addition, the confusion over trade statistics was another aspect of the problem of obtaining reliable information. For example, the Chinese custom figures on trade balances differed significantly from statistics of the Chinese Ministry of Foreign Economic Relations and Trade in 1985. Both differed from U.S. trade statistics.[15]

The U.S. also felt that China should use other means rather than rely on central control over foreign exchange to regulate and restrict the level of imports. Some Chinese practices which are inconsistent with the GATT regulations should be gradually eliminated. These practices include things such as border charges and taxes that are not incorporated in China's tariff system.

The last issue that the U.S. raised was that China's commodity prices should reflect supply and demand rather than state-fixed pricing. The U.S. was worried that China would mask subsidies for exports.[16] For this purpose, the U.S. wanted GATT to have a safeguard mechanism in order to protect market from possible disruptions of unfair trading. As a result, China has recently lifted state control over a large number of commodity prices and allowed market forces to determine pricing.

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[14] *People's Daily* , September 11, 1992, p1.

[15] Eugene K. Lawson Ed, *U.S.-China Trade*, 1988, pp11-12.

[16] For detailed U.S. positions, see Jacobson and Oksenburg, *China's Participation in the IMF, the World Bank and GATT*, 1990, pp99-100.

The trade relation between China and the U.S. was finally normalized when U.S. Secretary of Commerce Barbara Franklin visited Beijing in late December, 1992 to co-chair the seventh Sino-U.S. Commerce and Trade Joint Committee. For the Chinese part, this was the first time after the 1989 Tiananmen incident when a U.S. secretary of commerce visited the PRC. It was regarded as a big step toward better bilateral relations and a chance to ask for U.S. support. Both Premier Li Peng and the Minister of MOFERT (Li Lanqing) requested the U.S. to make every effort to support China's membership in GATT.[17] For the American part, this meeting also allowed the U.S. to reassess its trade relations with China, to probe further trade in and co-operation with China, and to resume some programmes that had been temporarily suspended. With the continued reforms in China and the normalization of Sino-U.S. trade relation, it seemed at the time that the United States was close to lending support to the resumption of China's GATT membership. But that did not happen. On the contrary, after two days of talks about China's GATT application on March 2nd 1993, America's trade negotiator Doug Newkirk expressed pessimism on China's entry to GATT in the near future.[18] During the negotiation, the U.S. reiterated those five points and demanded that any re-entry agreement must include a Chinese pledge to move to a full market economy and protection of other countries from "surges" of Chinese exports.[19]

4.2.2. Sino-Japanese Trade Relations

Unlike the U.S., Japan's trade relations with China and its geographic location make it more supportive of China's membership. Japan has been China's most important trading partner in the past two decades. It had been the largest single trading partner of China before Hong Kong took over. China's economic reforms and open door policies have propelled China into becoming Japan's second largest trading partner just behind the United States[20].

Geographic proximity and the complementarity of the two economies provided the basis for Japan's quick move into the Chinese market. Yet due to certain trading practices of Japanese companies, lack of Japanese investment compared to its trade volume with China, and historic Chinese mistrust of Japan, China unilaterally suspended more than $2 billion worth of contracts for Japanese equipment in what was called "China Shock" in Japan in 1979. With the rising value of the Japanese yen in the 1980s, Hong Kong has replaced Japan as China's largest trading partner. Yet, Japan still holds a large

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[17] *People's Daily* (Overseas Edition), December 19, 1992, p1.

[18] The Economist, *China and GATT*, March 6, 1993, pp35-6.

[19] Ibid., p36.

[20] Ma, Chengshan, "Japan" in Zhang, Peiji and R. W. Huenemann ed., *China's Foreign Trade*, 1988, p93.

percentage of China's trade. It was not surprising to see that Japan was the first major industrial country to rush an official delegation to China after the 1989 crackdown. Nor would it be strange to see that Japan was the first among major developed country to announce in late 1989 that the situation in China had returned to normal.

Due to these considerations, Japan does not oppose China's full participation in the GATT, but it does have concerns over whether China joins the GATT by resuming its seat in the organization. The concept of resumption posed particular difficulties for Japan due to its domestic law. Certain legal problems will arise if China resumes its membership in the GATT.[21]

China and Japan had a long history of doing business with each other. A freer, more accessible market in China means that Japan would not only continue to enjoy a favorable position in its trade with China, but also deal with a more predictable neighbor. Thus, Japan will not likely oppose China's full participation in the world trade organization. As Japan is an important member of the GATT, its support will certainly be beneficial to China in the negotiating process for re-entry to GATT.

4.2.3. European Community's Position

The European Community is the fourth largest trading partner of China following Hong Kong, Japan and the United States. But the EC and China seemed to have more misunderstanding in their trade negotiations than it has with the U.S. and Japan. Compared with the United States and Japan, the European Community was more cautious in investing in China and less involved in expanding possible China trade. However, China seems to believe that the share of the European Community in China's total foreign trade will reach 18-20 per cent by the end of the century.[22]

On the question of China's full participation in the GATT, the EC followed the American position as mentioned above. In addition, the EC insists on maintaining its currently imposed quota system against China's exports. This system set precise quantitative limits for all categories of China's exports to the members of the European Community[23]. The European community regards this as an effective mechanism to protect its interest in trade with China. The EC's willingness to enlarge or even drop the quota system will depend partly on China's domestic economic reform progress.

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[21] Jacobson and Oksenberg, *China's Participation in the IMF, the World Bank and GATT*, 1990, p95.

[22] Liu, Youhou, "Western Europe" in Zhang Peiji and R. W. Huenemann ed. *China's Foreign Trade*, 1988, pp101-9.

[23] Jacobson and Oksenberg, *China's Participation in the IMF, the World Bank and GATT*, 1990, pp100-1.

But to EC members the negotiation for China to resume its position in the GATT will likely be a long and complicated process due to EC's own unity problems and its many protective sentiments on the Continent. For China to gain approvals from all members of the EC might prove to be rather difficult.

Whether China can successfully re-enter GATT will certainly depend on the attitude of all major players of the organization. It will also depend on China's move towards a real market economy. China has been very optimistic about the resumption of its GATT seat in the near future. It has substantially reformed some of its foreign trade rules and reduced tariffs in order to meet the demands of the Contracting Parties. However, China has also been very clear in stating its own principles of rejoin GATT, which needs a close look.

4.3. China's Position

It is apparent that to the Chinese government, resumption of its GATT position has been the goal. Chinese officials have made it clear time and again that China wants to resume or restore its GATT seat rather than accede, join or rejoin the General Agreement as a new member. When the Chinese government made its formal application for the restoration of its full membership in the GATT, it stated three principles: "(1) China will join GATT by way of restoring her membership (as opposed to temporarily joining or rejoining); (2) China will commit herself to reducing tariffs, but not to increasing the percentage of imports; and (3) China should be treated like a developing country."[24]

4.3.1. Resumption Versus Accession

China's emphasis on restoring its position in the GATT, apart from procedural considerations, is thought to be "a question of sovereignty."[25] China strongly expressed that it "absolutely will not agree to take part in GATT by the method of 'joining' or 'rejoining'."[26] This is because China regards the withdrawal from GATT by Taiwan authorities in 1950 as illegal, null and void, since they did not have the right to represent the will of the Chinese people after the 1949 revolution. Following this logic, China argues that because the Taiwan withdrawal was without legal effect, China has in fact been a member of GATT all along and need not to apply or reapply to an international body to which it is a founding member.[27] What the People's

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[24] Qixiang Ye, "The United States" in Zhang Peiji and R. W. Huenemann (ed.) *China's Foreign Trade*. 1988, p91.

[25] Shangming Dong & Wang Lei. China and GATT in Zhang Peiji and R. W. Huenemann(ed.) *China's Foreign Trade*, 1988, p70.

[26] Ibid., p68.

[27] Robert E. Herzstein, "China and the GATT: legal and policy issues raise by China's

Republic wants is to be acknowledged as an original signatory of the GATT first, and then negotiate a new protocol of resumption.

China has done this in the United Nations and other international organizations and thus wishes to participate in GATT in the same manner. But GATT differs in nature from other international organizations in that it is in fact a tariff agreement among contracting parties rather than an independent world organization in which only sovereign countries are allowed as participants. Here, China seems to have misunderstood the sovereignty issue. In fact, according to the rules of GATT, members of the General Agreement can be either sovereign nations or customs territories. Recently China has shown some flexibility on this so-called issue of sovereignty by agreeing to Taiwan's participation in GATT as an individual member after the People's Republic resumes its GATT membership, but it hastens to add that Taiwan's membership in GATT does not contain the meaning of a sovereign nation.[28]

China's insistence on restoration of its seat in GATT also raises procedural problems. As discussed above, a government can accede to GATT as a new member under Article XXXIII which provides that the acceding party may participate in GATT "on terms to be agreed upon between such government and the Contracting Parties."[29] It was designed to help contracting parties deal with specific questions raised by the new relationship. In China's case, the contracting parties may use the Article XXXIII procedure to address the special problems resulting from the nature of China's economy and its trade practices. Besides, China has not participated in the GATT for the past 43 years during which great changes had taken place in the latter with many more concessions reached during China's absence. Thus even if China resumes its old seat, the GATT of today is a different economic and political entity from what it was in 1948 and China will still be a "new" member *de facto*.[30]

On the other hand, Article XXXV of the GATT is drafted to protect contracting parties' interests in case of a new membership by allowing an individual contracting party to refrain from granting GATT benefits to the new member. If China resumes its seat in GATT as an original member, Article XXXV could not technically be invoked because China would be in fact an old member. This will certainly create problems for some contracting parties, because China has a non-market economy, even though it is moving

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participation in the General Agreement on Tariffs and Trade" in *Law and Policy in International Business*. 1986, pp402-3.

28 *People's Daily* (Overseas Edition), October 1st, 1992. p3.

29 GATT,*The Text of the General Agreement on Tariffs and Trade*, 1986, p51.

30 Herzstein, "China and the GATT: legal and policy issues raise by China's participation in the General Agreement on Tariffs and Trade" in *Law and Policy in International Business*. 1986, pp407-8.

towards a market oriented one; and it is also a low-cost country which will likely have a dislocating impact on Western manufacturers.[31] Many GATT members have invoked Article XXXV in the past against countries such as Poland and Romania which are non-market economies, and against Japan when it was considered that Japan's low-cost manufactures could create problem of "unfair trading" to other contracting parties. China's participation in the GATT as an original signatory member would certainly pose problems and possibly jeopardize the ability of countries with such worries to invoke Article XXXV. In addition, if China is restored to its GATT seat, the U.S. will face some problems because of its need to invoke Article XXXV against China to satisfy the requirements of the Trade Act of 1974.[32] According to Section 402 of the Trade Act of 1974 the United States, the U.S. president must report to Congress that the country in question does not deny its citizens the right or opportunity to emigrate before the U.S. extends MFN status to any non-market economy.[33]

4.3.2. Tariff Concessions

On conditions of resumption, China has made it clear that it wishes to follow the examples of what the former Yugoslavia and Hungary have done in their accessions to GATT, i.e. based on tariff concessions. China has emphasized that the reforms in China, in particular the attempt to establish a market oriented economy as outlined in the Chinese Communist Party's 14th National Congress, will be successful in de-centralizing China's economy and should enable China to negotiate its participation in GATT on tariff concessions with other contracting parties.[34] In fact, Herzstein has suggested that the procedure used in the case of the former Yugoslavia be considered in negotiating China's accession, based on China's economic reforms and de-centralization of its economic and foreign trade system.[35] But, Yugoslavia's prolonged negotiation process is not what China wants. On many occasions, Chinese officials have urged the Contracting Parties to speed up China's resumption process and promised the GATT that China will carry out its obligations to other Contracting Parties through tariff negotiations. Chinese MOFERT Minister Li Lanqing promised at a press conference in Beijing on

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[31] McDonnell, "China's Move to Rejoin the GATT System: an Epic Transition" in *The World Economy*, 1987, pp342-3.

[32] See M.M Kostecki, *East-West Trade and the GATT System*, 1979, pp30-31; and Herzstein, "China and the GATT: Legal and Policy Issues Raise by China's Participation in the General Agreement on Tariffs and Trade" in *Law and Policy in International Business*. 1986, p383 & p407.

[33] McDonnell, "China's Move to Rejoin the GATT System: an Epic Transition" in *The World Economy*, 1987, pp343-44

[34] *People's Daily* (Overseas Edition, July 13th, 1992. p2.

[35] Herzstein, "China and the GATT: legal and policy issues raise by China's participation in the General Agreement on Tariffs and Trade" in *Law and Policy in International Business*. 1986, p409.

October 15th, 1992 that China would not only enjoy the privileges granted to other GATT members, but also fulfill its obligations to the Contracting Parties in reducing tariffs after the resumption.[36] Tong Zhiguang, deputy minister of MOFERT and head of China's delegation to the 11th GATT Working Meeting on China's application, also expressed China's desire to seek a "balance between China's rights and obligations" in GATT after its resumption.[37]

Besides the rhetoric, China has decided to take steps to reform its foreign trade regime, especially the import system, as part of the answer to the Contracting Parties' concerns over the transparency in China's trade regulations.[38] GATT members were concerned over the role of government, since most of the large purchases were done by the central government. They also worried about China's pricing policies which they regarded as not reflecting the market supply and demand.[39] In a recent announcement, Gu Yongjiang, another deputy minister of MOFERT, outlined new reform measures in import management in order to reduce the role of government in China's import regime. Accompanied by necessary administrative measures, China will establish an import system based on the use of tariffs as leverage. The proposed reforms in the import system include gradually eliminating government restrictions on imported goods and assembly manufacturing facilities, establishing the use of open quotas system according to GATT rules, abolishing state subsidies to import goods, reducing the number of goods that require import permits and lowering total tariffs on a gradual basis. Gu says that these measures are requirements of the GATT and in the long run will help China compete in the world market.[40] However, if these measures are applied, China's national industry will inevitably feel the impact of the influx of foreign goods and perhaps cheaper products. Yet still China wishes to resume its full participation in the GATT on the basis of reducing tariffs and allowing possible expansion of imports. In other words, China wants to have commercial relationships between it and the Contracting Parties conducted in conformity with the rules of the GATT, but to the extent possible under China's economic system and development stage.

4.3.3. China's Developing Country Status

Despite China's size and its advanced achievements in certain fields such as satellite launching and nuclear technology, China cannot be classified as either an industrialized country or a newly industrialized one. As the world's most populated country and one of the major powers, China maintains that it remains a developing country because of a low per capita

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[36] *People's Daily* (Overseas Edition), October 16th, 1992. p3.
[37] Ibid., October 26th, 1992. p6.
[38] GATT, *Focus*, No. 62. June, 1989. p10.
[39] Hartland-Thunberg, *China, Hong Kong , Taiwan and the World Trading System*, 1990, pp89-91.
[40] *People's Daily* (Overseas Edition), October 30th, 1992. p1.

income of just US$370 in 1991.[41] Thus, when applying for the resumption of its GATT seat, China demands that the Contracting Parties consider China as a developing country and grant it the GATT regulations regarding developing countries. In fact, Deputy Minister of MOFERT, Gu Yongjiang, states that China will gradually advance administrative management skills to better develop infant industries according to the GATT provisions which protect the development of such industries in the developing countries.[42]

During the years of the GATT existence, the General Agreement has formulated several rules dealing with the trade and development problems of developing countries, (less-developed-countries in GATT's term). The major addition to the GATT rules which cover the trade and development of the less-developed-countries is Part IV of the General Agreement, the result of the Kennedy Round of GATT talks. One of the most important rules in Part IV is Article XXXVI:8 which states that " the developed contracting parties do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties."[43] This rule has given less-developed-countries more flexibility in their dealings with tariff concessions with the developed countries, and at the same time allowed them to enjoy the rights to most-favored-nation treatment. While the negotiations between developed countries have been based on the principle of full reciprocity between concessions granted and received, they cannot expect the same level of reciprocity from the less-developed-countries. In addition to this rule, the less-developed countries also can use quantitative restrictions "where necessary to protect their balance of payments and, in cases where the use of the tariff is impracticable, to protect developing industries."[44] China so far has a very strong balance of payments in 1991, yet it can still use this rule to protect its infant industries once it resumes membership in GATT with the qualification of a developing nation.

Two other provisions are formulated by the GATT to help the trade and development of the contracting parties who are less-developed countries. One is the possible use of subsidies and other measures which can be restrictive of international trade by the less-developed countries, "subject to a general obligation, in case of subsidies on the exports of primary products, not to use such subsidies so as to secure for themselves 'a more than equitable share in world trade in the products concerned', bearing in mind that other contracting parties, in certain circumstances, are permitted to apply countervailing duties".[45] And the other is the provision of state trading by the

[41] GATT, *International Trade 90-91*, 1992, Vol. I. p57.
[42] *People's Daily* (Overseas Edition), October 30th, 1992. p1.
[43] GATT, The *Text of the General Agreement on Tariffs and Trade*, 1986, p53.
[44] GATT, *The Role of GATT in Relation to Trade and Development*, 1964, p19.
[45] GATT, The *Text of the General Agreement on Tariffs and Trade*, 1964, pp19-20.

less-developed-countries "acted on the basis of ordinary commercial considerations."[46]

Under the GATT provisions on trade and development of the developing countries, China, if accepted in the category of less-developed-countries, will certainly benefit not only from the general privileges that accorded to a GATT member, but also enjoy a possible export expansion under the protection of those rules. Since during the previous years, "not only has the General Agreement been amended several times to elaborate further the rules governing less-developed-country trade, but the GATT as an institution has changed from a passive caretaker of a multilateral legal instrument to an international body affirmatively, and at times aggressively, attempting to promote the exports of less-developed-countries."[47] As a less-developed-country, China's full participation in GATT will ensure a favorable position for China to develop its industries and expand its export with limited obligations to offer reciprocity treatment to other contracting parties.

4.4. Summary and Conclusions

During the negotiation, key member states of GATT, especially the United States and countries of the European Community have expressed concerns over China's economy. They regard China's economy as not up to the stage for full, unconditional GATT membership. The Americans raised five points, demanding uniformity of China's trade regime and transparency of trade policies. The EC also insists that it keep quantitative restrictions over China's exports until a time that China's economy become driven by market forces. These concerns and demands are mainly based on the involvement in their trade with China, the access to the Chinese market and their direct investment in China. Another key member of GATT - Japan has been more supportive of China's accession to GATT, primarily due to geographic proximity and, especially, complimentary of the two economies.

In the talks, China also put forward three demands as conditions to join GATT. The three principles, as the Chinese calls them, include the demand for a resumption of China's old seat; entering the Contracting Parties on bases of tariffs concession and China being treated as a developing country. These principles illustrate clearly that China intends to join GATT on terms similar to other acceding contracting parties so that it will both enjoy the benefits accorded to the contracting parties and be protected at the same time by the provisions of the GATT as a less-developed country.

Recent negotiations seem to have put the position between China and major GATT members further apart as each side emphasizes its own points.

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[46] GATT, The *Text of the General Agreement on Tariffs and Trade*, 1964, p20.
[47] Dam, *The GATT Law and International Economic Organization*, 1970, p225.

A quick solution now appears to be unrealistic at the present. However, many of the worries of Western industrial countries might be dissolved if China continues to reform its economic structure to make it a market based economy. Continued reforms in China will offer a solution to most of the existing problems facing China's participation in GATT. Given this, there are several options for China's participation in the General Agreement. In the next chapter, we will exam and compare those options.

Chapter Five

Solution: A Full GATT Membership?

Economic reforms and the experience with the world's major economic organizations such as the World Bank and the International Monetary Fund have prepared China to resume its membership in the General Agreement on Tariffs and Trade. Further shifts to a market oriented economy in China's economic structure will certainly create a favourable environment for China to meet the demands of the contracting parties. But because of the complexity of China's existing economic structure, its great impact on world trade, its enormous potential market, and the size of its economy, China's membership in GATT still causes concerns for the GATT Contracting Parties and commands careful consideration of the international trade regime.

Conditions now appear to be ready for China to participate in the world trade organization and the discussions about China's accession to GATT have quickened due to both China's anxiety and its reform process, and the willingness of the GATT organization to consider China, the 15th largest trading country in the world in 1991 and Taiwan, the 14th in the world back to the GATT framework[1]. China's accession to GATT will also guarantee Hong Kong, the 10th largest trading member in the world, to continue participating in the GATT after 1997 when China resumes its control over the former British colony. The GATT can no longer ignore the economy of the greater China, including the People's Republic, Taiwan and Hong Kong, and thus is willing to speed up its process to negotiate China's membership application in the 11th GATT working meeting on China's participation in Geneva.[2] A working party was scheduled in March, 1993 to examine the drafting of a protocol of accession on China's re-entry to GATT, a first step for GATT membership.[3]

Analysts have mapped out several options for China to participate in the GATT organization. Those solutions include suggestions such that China be accepted as a full member or as a member with limited capacity. In addition, there are procedural problems as well. For example, the question has to be answered whether China is to resume its original seat with all its rights associated with the resumption, whether China is to be accepted as a new member with the possibilities that other members of the Contracting

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1 *People's Daily* (Overseas Edition) September 2nd, 1992. p1.

2 The GATT announced that it will speed up negotiation process on the assumption of China on September 29th, 1992 and held its 11th working meeting on China's application between October 21st and October 23rd, 1992

3 Zarocosta, "Early GATT Entry Unlikely for China, Western Officials Say" in *Journal of Commerce*, March 2, 1993. p27

Parties can invoke reservation to China's accession under GATT regulations, or whether China is to be presented as a special case that requires a special process for its accession. Attempts are made in this Chapter to seek answers to these questions and to discuss possible solutions for China to accede under current circumstances.

There has been no doubt among the contracting parties that China will become a contracting party of the General Agreement and that its full participation in GATT is just a matter of time and procedures.[4] The members of the GATT Working Party on China considered that "greater integration of China in the world trading system could have beneficial effects for China and help the country modernize its economy and accelerate its development. It would also benefit GATT members and help to strengthen the trading system,..."[5] However, procedural problems still have to be worked out before the Contracting Parties can find a solution for China to resume its GATT seat. Several possibilities for China to re-join the GATT have been suggested by analysts who seek ways to satisfy both China and other contracting parties. These suggestions can be classified as three kinds: a) a limited membership subject to restrictions pursuant to Article XXXV; b) a membership with gradual process of stages leading to a full membership and finally c) an unlimited membership.

5.1. Limited Membership

The possibility of a limited membership subject to the restriction of Article XXXV for China in the General Agreement has been dismissed by many analysts for two reasons. First, China wants to restore its old seat in the GATT as an original signatory of the GATT which, as discussed above, technically blocks the invocation of Article XXXV by the contracting parties to an "old member" of the General Agreement. Article XXXV permits members of the GATT to refrain from establishing a GATT relationship with a new country and thus can generally be utilized to deal with new acceding parties. Secondly, employment of such provisions will inevitably cause harm to the GATT whose purpose is to encourage the liberalization of trade, rather than a deterrence to world trade. When examining the invocation of Article XXXV against Japan, "the Working Party suggested that the need for Article XXXV would tend to disappear if 'satisfactory multilateral solutions' could be found to the problem of 'market disruption'."[6]

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[4] See Hartland-Thunberg, *China, Hong Kong, Taiwan and the World Trading System*, 1990, p79 and Jacobson & Oksenberg, *China's Participation in IMF, the World Bank, and the GATT*, 1990, p96.

[5] GATT, *Focus*, No. 53. Feb./March, 1988, p8.

[6] McDonnell, "China's Move to Rejoin the GATT System: an Epic Transition" in *The World Economy*, 1987, p345.

To address the apprehensions of China's entry into GATT which might cause market disruption, China emphasizes that its resumption of the GATT seat will not exert pressure on the contracting parties because of its small percentage of export in world trade and its large domestic market. "China follows a policy of striking a balance between import and export; when export increases, its import will increase accordingly."[7] Furthermore, a limited membership will not be accepted by the Chinese government since it has simply refused to join the GATT as a new member.

5.2. Staged Membership

Robert Herzstein, a Washington, D. C. lawyer and former Under Secretary for International Trade at the U.S. Department of Commerce (1980-81) suggested that China enter the GATT through a process with six distinct stages. These stages are: information gathering, establishing milestones, tariff negotiations, experimental association, phasing in GATT benefits and finally full GATT membership. The gradual stages will on the one hand "allow the GATT member countries time to familiarize themselves with China's trading system and the potential impact of Chinese products on their import-sensitive industries", and on the other "allow China gradually to adjust its own trade practices and institute the economic reforms needed for effective two-way participation in the international trading system."[8]

The staged process is more elaborate than the steps followed by other non-market economies because Herzstein figures that the distinct stages procedure will give GATT members time to get acquainted with China's foreign trade regime. However, China has in fact been doing trade with many GATT members on the basis of bilateral trade agreements, many of which allow most-favored-nation treatment. In addition, eighty-five per cent of China's trade has been done with GATT members who are certainly familiar with China's trading system. Thus, the staged process may not serve the purpose of letting GATT members familiarize themselves with China's trading system but rather create more problems for both China and the Contracting Parties in their trade endeavors due to the procedure.

Moreover, the staged membership procedure will certainly be time consuming. But Herzstein thinks that it is necessary, because it will help China establish institutions to operate a market-oriented economy. In his view, a mere reduction of China's customs tariffs will not be enough to satisfy the GATT contracting Parties.[9] Herzstein's idea is not echoed by J.E.D.

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[7] "China positions Itself to Rejoin GATT", *Beijing Review* , No. 10. March 10th, 1986, p4.

[8] Herzstein, "China and the GATT: legal and policy issues raise by China's participation in the General Agreement on Tariffs and Trade" in *Law and Policy in International Business*. 1986, Vol. 18. p413.

[9] Ibid., pp385-6.

McDonnell, a lawyer and economist, formerly an Assistant Secretary in the Department of Trade, Government of Australia and an Adviser to the Ministry of Foreign Economic Relations and Trade in the People's Republic of China, who, after analyzing China's foreign trade regime and its economic reforms, begs disagreement. McDonnell stresses that China is "the wrong kind of country to have policy introduced on the basis of gradualism, and that "the policy of conformity with the GATT will have to be introduced as a once-and-for-all policy to avoid confusion."[10] He points out that the GATT obligations will promote faster changes in China and that the inducement for China to change will need to be the promise of reasonable reciprocity from contracting parties.[11]

China has been on the course of "opening-up" to the outside world in the past 15 years and carried out economic reforms for over a decade. Recently, China decided to move towards a market oriented economy and made substantial changes to its foreign trade regime and its pricing system. These changes are partly in answer to the demands of the contracting parties. As a matter of fact, China's efforts in reforming its economy in the past decade may be regarded as a gradual-staged readjustment to participating in the GATT. Even though the readjustment may not yet be fully up to the standard of GATT, the changes have significantly transformed the nature of the Chinese economy. Another lengthy process seems to be both time consuming and unnecessary. In addition, gradual membership might give an excuse to conservative forces in China to attack economic reforms because the constraints set out by GATT might be viewed by some in China as hostile. A gradual membership with constraints could also mean to some that China, being one of the major powers in the world, has lost its face, one of the most important thing in the Chinese culture. Thus, instead of promoting changes towards a market economy in China, a staged membership might just do the opposite.

5.3. Unlimited Membership

The arguments set out earlier and the discussions on China's particular situation lead to the final solution: an unlimited membership for the People's Republic of China. McDonnell believes that China, which is best characterized as a developing country with a "developing mixed economy" like that of Mexico, ought to be treated likewise.[12] Admitting that there are still problems to be dealt with, he advocates for a return of China's seat in the GATT "sooner rather than later and on terms which will encourage economic reform, not stifle it."[13]

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[10] McDonnell, "China's Move to Rejoin the GATT System: an Epic Transition" in *The World Economy*, 1987, p346.

[11] Ibid., p346.

[12] Ibid., p348.

[13] Ibid., p348.

Despite the problems, it seems to be most plausible and beneficial for China to resume its participation in the General Agreement, for the following reasons. First of all, the GATT is a multilateral trade agreement to promote and expand world trade on a multilateral basis. A resumption of China's seat in the GATT will promote the spirit of the GATT which aims to advance world trade rather than circumvent it. A limited membership or a prolonged staged solution to China's attempt to resume its full participation in the GATT will probably not bring advantages to either China or the contracting parties. Moreover, these procedures are less likely to promote the principles of the GATT which call for freer trade, and represent instead an encouragement of trade protectionism which is what the GATT has been established to fight against.

Second, full membership in the GATT will help China's on-going economic reforms, especially the attempt to move China's economy toward a market-oriented one, which, in the long run, will not only bring gains to the Chinese people, but also provide benefits to everyone in the world community. Unlike the proposed staged membership, a full membership in GATT may help curb hardline communists in China to stop market reforms and allow reform forces to press for a more liberal market economy. This is because the anticipated benefits to the Chinese economy, after China becoming a full member of GATT, will serve as proof of the success of economic reforms.

The third reason is that China has close to one-fourth of the world's population with the largest untapped market in the world. An unlimited membership in the GATT will create favorable conditions to open what is potentially the world's largest market rather than bring obstacles to close it. China's drive to rejoin the GATT has been part of its "opening to the outside world". The GATT membership will ensure the continuation of such efforts. The denial of China's full unlimited membership in the General Agreement would not be helpful in opening China to the outside world and worse still, it might even make China retreat to its old chrysalis because China tends to believe that it was the centre of the universe and that its economy could be sufficient on its own.

And finally, the fourth reason lies in the fact that China, including Taiwan, Hong Kong and the People's Republic, is the third largest trader in the world after the United States and European Communities, surpassing Japan, a phenomenon no one should ignore. A full membership for the People's Republic in GATT will see a successful solution to the accession of Taiwan and the continuous membership status of Hong Kong.

It is true that there still exist several problems if China resumes its full membership in GATT. For example, as the American pointed out after the 1993 March meeting that China still need a uniform system of trade rules

throughout the country and its pricing system still reflect the nature of a non-market economy.[14] China's economic structure is still based on a centrally planned economy and the road to create a market economy is going to be long, tortuous and sometimes maybe even painful. China still has to make profound adjustments in its economic structure and foreign trade system in order to meet all the requirements of the GATT. Furthermore, as a developing country with a large economy, China's participation in GATT will exert a great impact on the Contracting Parties. Due to China's size and its potential for trade, a change of China's status in GATT is a significant move, which will be felt not only by the developed countries but by the less-developed. However, a full unlimited GATT membership for China will certainly promote changes in China's economic structure which in turn will benefit all contracting parties. Therefore, it seems in the interest of the Contracting Parties that they should avoid Sinophobia and strongly support that "China should assume, to the fullest extent, the obligations of GATT membership."[15]

5.4. Summary and Conclusions

Since the establishment of the General Agreement on Tariffs and Trade, the GATT has expanded to become a trade organization which consists of 106 governments in the world. During the course of its existence, the GATT uses four procedures to admit new members. They include accession under Article XXXIII, i.e. through negotiations, accession by declaration through sponsorship, de facto membership in the GATT and provisional arrangement in special cases. However, China's application to membership in the GATT cannot simply follow any of those four procedures. That is because, as a original signatory state, China demands to resume its "old seat" in the GATT as opposed to joining the General Agreement as a new member.

Under such circumstances, the problem for the Contracting Parties is three fold: a) if China is to resume its old seat, the contracting parties most concerned, for example, the United States, will be technically unable to invoke Article XXXV against China but faces the problem of its Trade Act of 1974 which requires the United States to do so;[16] b) China's economic structure and its foreign trade regime which is based on a centrally planned economy and lack of necessary institutions to operate a market-oriented economy may require time for adjustments;[17] and c) the Contracting Parties

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[14] See "China and GATT" in The Economist, March 6, 1993, p36.

[15] McDonnell, "China's Move to Rejoin the GATT System: an Epic Transition" in *The World Economy*, 1987, p349.

[16] Herzstein, "China and the GATT: legal and policy issues raise by China's participation in the General Agreement on Tariffs and Trade" in *Law and Policy in International Business*. 1986, pp382-4.

[17] McDonnell, "China's Move to Rejoin the GATT System: an Epic Transition" in *The World Economy*, 1987, p346.

may feel that a tariffs concession alone approach may not be enough as China's only "entrance fee".

These problems will be solved only if China continues to carry out its economic reforms and move towards a more liberal and market oriented economy. A full unlimited GATT membership will push China to quicken its reform paces, guarantee China's adjustments within the GATT framework and tap fully China's market potentials. A full unlimited GATT membership will promote the principle of freer trade in the world and ensure the inclusion of the greater China in the world trade organization. China's full unlimited membership in the GATT will eventually benefit not only the Chinese people, but all people in the world.

Conclusion

Since China's bid to re-enter the General Agreement is an important, epoch-making event, its implications to international trade and relations are tremendous. A full membership for China in the GATT without any limitations will benefit not only the Chinese people, but also all people of the world. This is due to the fact that the resumption of China's GATT seat will bring one-fifth of the world population into the international trading system and open the largest potential market in the world. It will in fact increase the international representation of the General Agreement and better serve the purpose of the GATT to reduce tariffs as well as non-tariff barriers among nations and to promote free trade. In addition, with the resumption of China's membership in the GATT, the world trade organization will make Taiwan's membership a possibility and secure the continued participation of Hong Kong after 1997. After all the GATT would not want to ignore the combined trade figures of the "greater China" if it claims to be a world trade regime.

This thesis has examined the pertinent issues facing China's re-entry to GATT and the current situation where the Contracting Parties and China are still at odds as to how the latter should be accepted. Options are probed and arguments are made for China to enter the GATT as a full member both because of China's own economic reform which has greatly transformed China's economic structure and because of China's position in world trade. It is true that problems still exist in China's negotiation to enter GATT, but further movement towards a market oriented economy in China should eliminate most of the concerns raised by industrial countries.

Apparently, the incompatibility of a centrally planned economy and the principles of the GATT would be the major obstacle facing the People's Republic to enter the GATT. However, GATT has accommodated other countries with centrally planned economies and state trading practices even it is not equipped to do so. With the continued reforms in China's economic structure, it is hopeful to see the emergence of an economy based on market principles in China to replace the current centrally planned economy. This will satisfy most of the demands by the contracting parties. The sectors of the Chinese economy studied here show that they have undergone tremendous changes and continue to change, as the country tries to introduce a "socialist market economy". The on-going economic reforms in the People's Republic will eventually see China become a country with mostly a market economy. These reforms will not only transform China's economic structure to make it more compatible with the principles of the GATT but also allow the Contracting Parties to more favorably consider China's re-entry to the GATT. In turn, the resumption of China's GATT seat will speed up the reform process by creating opportunity for the reform forces inside China to press for a more liberal, market-based economic structure.

China's participation in the other key international economic organizations is valuable experience which will undoubtedly help China adapt in GATT as a full member. China claims to be willing to seek balance between its rights and obligations, which exhibits China's intention to abide by the rules of the General Agreement. From its experience in the IMF and the World Bank, China has earned good credits in both organizations and become a major spokesman for the less-developed-countries. It will probably continue to do so in the GATT if it resumes its seat.

It is true that the resumption of China's seat in the GATT is a more complicated matter than its participation in the IMF and the World Bank. It needs further concessions by both China and the Contracting Parties. More negotiations are still needed to hammer out terms that satisfy both China and the Contracting Parties. But China has undergone enormous changes in the past decade since its return to the international economic organizations, changes for a better, more prosperous society and changes for a more market oriented economy. It is to the best of both China and the GATT to encourage these changes and resume China's participation in the GATT to its full capacity.

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